



Minnesota Department of Finance

February 2002

Highlights

Projected Budget Deficit for FY2002-03 Increases by \$336 Million

Minnesota's budget deficit is now expected to reach \$2.289 billion by the end of the 2002-03 biennium, \$336 million more than forecast in November. State revenues are now forecast to total \$25.154 billion, \$300 million (1.2 percent) below November's estimate. Projected general fund spending has increased by \$36 million or 0.1 percent.

Technical Adjustment to Sales Tax Forecast Reduces FY2003 Deficit by \$122 Million

Language in the 2001 law eliminating the June accelerated sales tax payment was incorrectly drafted and did not reflect the intent to eliminate it for FY 2003. Accelerated payments are now assumed to be required through fiscal 2003, not end in fiscal 2002 as assumed in November. Without this change, the fiscal 2002-03 deficit would have increased by \$458 million.

Budget Outlook for 2004-05 Biennium Worsens; February Planning Estimates Show Budget Gap of \$3.214 Billion

The projected budget gap for FY 2004 is now \$1.673 billion, \$372 million more than November's estimate. Minnesota's structural deficit in FY 2005 is projected to be \$1.541 billion.

Economic Outlook for 2002 Improves Modestly, But Current Receipts Have Been Below Forecast

Economists have grown more optimistic about the U.S. economy's near-term prospects, and DRI has raised its outlook for real growth in FY 2002. Unfortunately that stronger short-term growth was not sufficient to fully offset future revenue losses due to the drop in the current revenue base. Historically, state revenues do not begin to recover until well after the expansion is underway.

Withholding tax receipts through January were \$40 million below November's estimate, and gross sales tax receipts, \$14 million below forecast. Fourth quarter estimated income tax payments were \$60 million (more than 16 percent) below projections.

Budget Summary

Budget Gap Widens to \$2.289 Billion

Minnesota's budget outlook has continued to weaken since November's forecast. Through January, actual receipts were \$69 million less than forecast. The economic outlook does appear to be improving, but state revenue growth always lags the resumption of growth in the economy. The revenue forecast for the current biennium has been reduced by \$300 million, while the biennial spending estimate increased by \$36 million. The budget deficit for the 2002-03 biennium is now estimated to be \$2.289 billion.

FY 2002-03 Budget Summary

(\$ millions)

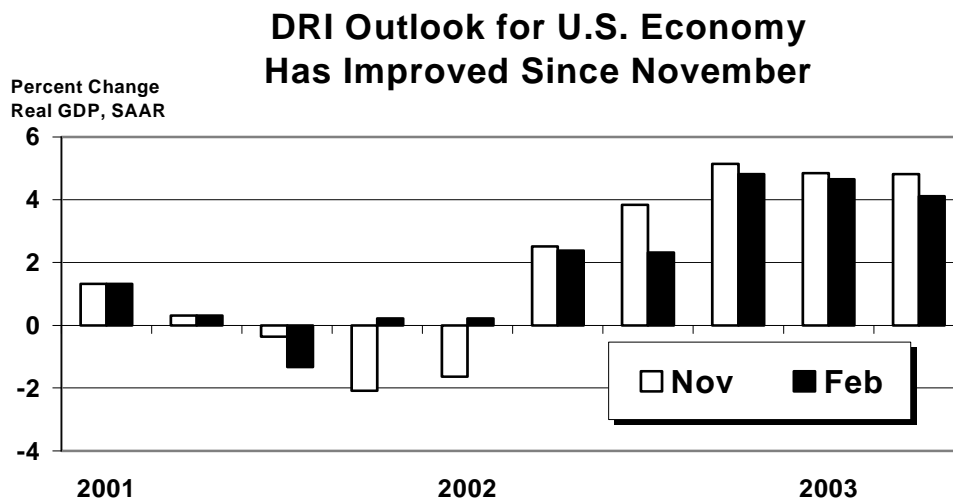
	<u>Nov 2001</u>	<u>Feb 2002</u>	<u>Change</u>
Beginning Balance	\$ 1,574	\$ 1,574	\$ 0
Forecast Revenues	25,454	25,154	(300)
Estimated Expenditures	27,806	27,842	36
Reserves			
Cash Flow Account	350	350	0
Budget Reserve	653	653	0
Tax Relief Account	158	158	0
Other Reserves	<u>14</u>	<u>14</u>	<u>0</u>
Projected Deficit	\$(1,953)	\$(2,289)	\$(336)

A reduction in the income tax forecast accounts for the majority of the change in revenues. However, FY 2003 sales tax receipts were increased by \$122 million due to a change in assumption about the date on which the June accelerated payment would be eliminated. Without this adjustment the forecast deficit in the current biennium would have increased by \$458 million. That same adjustment reduced FY 2004 revenues by \$130 million.

The Recession Is Almost Certainly Over

The 2001 recession is now expected to be the mildest on record. Advance estimates from the U.S. Department of Commerce show real GDP growing at a 0.2 percent in the fourth quarter, and almost every forecaster believes real GDP will continue to grow in the first quarter. That means real output will have declined in only the third quarter of 2001.

But, when broader measures of the economy are used, the recession looks more severe. Thus far payroll employment has declined by nearly one percent, and the unemployment rate has increased by 1.3 percentage points since March, 2001. Since few expect job growth to resume before early summer, the U.S. unemployment rate is likely to exceed 6 percent before a recovery is fully underway. Everyone recognizes that a slowing in the rate inventories are being depleted will provide a short-term boost to output, but inventory changes by themselves will not be enough to put the economy on track for an extended period of growth.

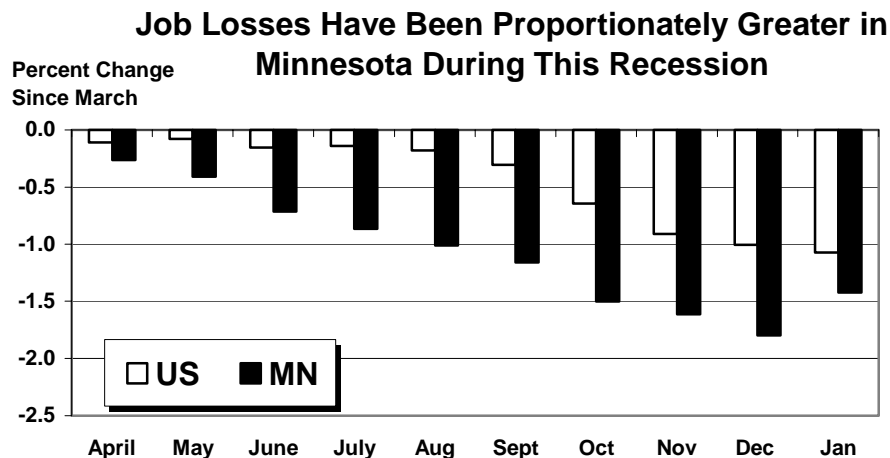


February's forecast from DRI-WEFA, Minnesota's national economic consultant, shows economic growth proceeding slowly through the first half of 2002, then taking off after mid-year. Real GDP growth of 0.2 percent is now projected for fiscal 2002, up from November's forecast of a 0.2 percent decline. For fiscal 2003, the real growth rate is largely unchanged dropping 0.1 percentage point to 2.8 percent.

Full recovery, and a return to annual real GDP growth rates averaging 3.5 percent or more will require stronger consumer spending, increases in payroll employment, and a rebound in business capital equipment outlays. Most forecasters expect that each of those challenges will be met, but there are no guarantees. Business spending may not respond in a timely fashion, or the national economy might not strengthen sufficiently by fall when lower state and local expenditures will offset strength elsewhere. If all conditions necessary for a high growth economy are not met, the alternative is not necessarily another recession, but an extended period of sub-par growth, as occurred in the early 1990s.

This Economic Downturn Has Been More Severe In Minnesota

During the past 10 months employment and wages have declined more rapidly in Minnesota than nationally. Through January payroll employment in Minnesota fell by 1.4 percent. The national average decline over that period was 1.1 percent. On a year-over-year basis Minnesota lost more than 37,000 jobs through January.



Minnesota wage growth also appears to have failed to keep pace with the national averages. Using state withholding tax receipts as a guide, Finance Department economists estimate that Minnesota wages fell by one percent between the fourth quarter of 2000 and the fourth quarter of 2001. Withholding receipts through late February indicate that Minnesota wages are also likely to have fallen by one percent in the first quarter of 2002. If this is true, this would be the first time in at least 40 years that wages had fallen from year earlier levels. That weak wage growth and declining employment are the key economic factors affecting this revenue forecast.



Differences between Minnesota's wage growth and its U.S. counterpart are so extreme that it may indicate a downward revision in the national estimates is likely. Preliminary national estimates are less likely to pick up changes in bonus payments or declines in the value of stock options exercised since data reported by employers to the unemployment insurance system is not used before final revisions are made. A substantial downward revision to U.S. wages could affect the outlook for the recovery in 2002.

Revenue Forecast Down \$300 Million from November's Estimate.

Minnesota's general fund revenues for the current biennium are now expected to total \$25.154 billion, \$300 million (1.2 percent) less than forecast in November. As noted above a change in the date assumed for the elimination of the June accelerated sales tax payment added \$122 million to FY 2003 sales tax revenues.

FY 2002-03 Revenues

(\$ millions)

	<u>Nov 2001</u>	<u>Feb 2002</u>	<u>Change</u>	<u>% Change</u>
Individual Income	\$12,191	\$11,788	\$(403)	(3.3)%
Sales	7,492	7,586	94	1.3%
Corporate	1,202	1,156	(46)	(3.8)%
Motor Vehicle Sales	666	693	27	4.1%
Statewide Levy	<u>893</u>	<u>891</u>	<u>(2)</u>	<u>(0.2)%</u>
Subtotal	22,444	22,114	(330)	(1.5)%
Other Non Dedicated Revenues	2,969	2,993	24	0.8%
Other Resources	<u>41</u>	<u>47</u>	<u>6</u>	<u>14.6%</u>
Total Resources	\$25,454	\$25,154	\$(300)	(1.2)%

Continued weaker than projected collections have lowered the base for both the income and the sales tax. The result is that the revenue outlook for the biennium is weaker, even though the economic outlook for early 2002 has improved slightly.

The individual income tax showed the largest decline, \$403 million. Projected lower wage and salary growth and a drop in projected portfolio income produced the majority of the reduction in the forecast. The motor vehicle sales tax forecast was increased by \$27 million reflecting the continued strength in auto sales since the start of 2002.

Forecast Spending Shows Little Change

Forecast spending for the biennium is now expected to be \$27.842 billion, up \$36 million (0.1 percent) from November. The health care spending forecast increased \$64 million and intergovernmental aids added \$18 million. Those increases were partially offset by forecast reductions of \$28 million for education finance, \$10 million in health and human services savings, and \$8 million in all other spending areas.

FY 2002-03 Estimated Expenditures

(\$ millions)

	<u>Nov 2001</u>	<u>Feb 2002</u>	<u>Change</u>
Education Finance	\$11,147	\$11,119	\$(28)
Higher Education	2,853	2,853	0
Intergovernmental Aids	2,847	2,865	18
Health Care	4,648	4,712	64
Health & Human Services	2,080	2,070	(10)
All Other	<u>4,231</u>	<u>4,223</u>	<u>(8)</u>
Total Spending	\$27,806	\$27,842	\$ 36

The \$28 million reduction in the forecast for education finance is driven primarily by decreases in the general and special education programs. Although actual FY2001 student counts are 198 higher than those forecast in November, a change in the mix of students and other factors produced an overall decrease in spending for FY2002-03.

Estimates for health care spending in the current biennium are now expected to be \$64 million higher (1.4 percent) than estimated in November. In total, Medical Assistance Long-Term Care Waivers are projected to be \$54 million higher than earlier figures due to caseload increases and higher average costs. Estimates of the General Assistance Medical Care are now 2 percent higher, an increase of \$8 million.

Revenue Losses Continue Through 2004 and 2005

Revenue planning estimates now show current resources for FY 2004-05 totaling \$28.375 billion, \$671 million less than projected in November. Expenditures are forecast to be \$7 million more than November's estimates. A budget gap of \$3.214 billion is now projected for the 2004-05 biennium. The structural deficit for FY 2005 is now estimated to be \$1.541 billion.

FY 2004-05 Planning Estimates

(\$ millions)

	<u>Nov 2001</u>	<u>Feb 2002</u>	<u>Change</u>
Resources			
Non Dedicated Revenues	\$28,846	\$28,178	\$(668)
Transfers, Other	<u>200</u>	<u>197</u>	<u>(3)</u>
Total	<u>29,046</u>	<u>28,375</u>	<u>(671)</u>
Spending			
Baseline	30,455	30,462	7
Estimated Inflation	<u>1,127</u>	<u>1,127</u>	<u>0</u>
Total	<u>\$31,582</u>	<u>\$31,589</u>	<u>\$7</u>

Even though the economy is assumed to grow at a normal rate during 2004 and 2005, that growth comes from a lower base that adds to the permanent revenue loss, and projected budget gaps widen. Expenditure planning estimates for FY 2004-05 show little net change. The inflation rate used over the planning horizon remains unchanged at 2.5 percent per year.

FY 2003-05 Structural Balance

(\$ millions)

	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>
Revenues	12,975	13,771	14,603
Spending:			
Baseline Spending	14,651	15,077	15,384
Estimated Inflation	<u>n/a</u>	<u>367</u>	<u>760</u>
Total Spending	14,651	15,444	16,144
Difference	(1,676)	(1,673)	(1,541)

A complete version of the February 2002 forecast can be found at the Department of Finance's World Wide Web site at – www.finance.state.mn.us. This document is available in alternate format.

Economic Summary

The recession of 2001 appears over. It was not the shortest recession in history, the 1980 downturn lasted just 6 months, but unless the advance estimate of fourth quarter GDP is revised down significantly, it will have been the mildest.

Most forecasters were pleasantly surprised by the 0.2 percent real GDP growth reported for fourth quarter 2001. That, combined with the generally up beat economic reports issued since the first of this year, encouraged almost everyone to increase their short-term forecast. But, few expect the typical early-expansion bounce with one or two quarters of abnormally high real growth. Most economists believe the pent-up demand necessary for a surge in consumer spending is simply not in place. Instead, forecasts of steady economic growth averaging between 3 and 4 percent through 2003 are common. That slow and steady growth accompanied by low inflation is generally seen as providing a good foundation for another long economic expansion.

Of course, there are no guarantees. January's disappointing 89,000-job decline in payroll employment is a useful reminder of the economy's current weakness. Restoring the 1.4 million jobs lost over the past 10 months and establishing the conditions needed to support steady real growth at a rate of 3 to 4 percent will require time.

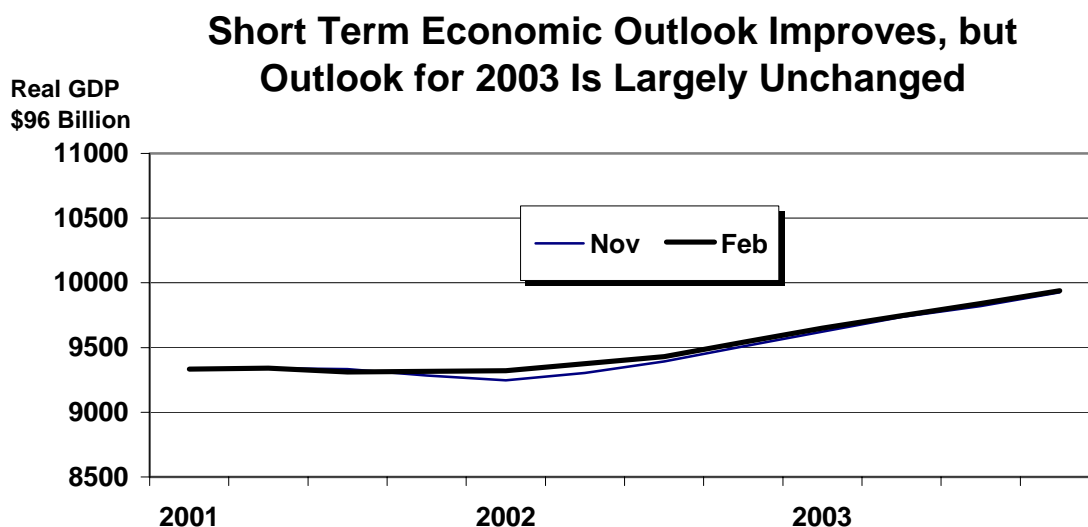
The first step, bringing an end to the inventory correction is, almost certainly, underway. That is expected to lift the economy during the first six months of 2002. The turn in the inventory cycle alone though, will not be enough to place the economy firmly on track for an extended period of growth. Healthy increases in consumer spending will need to occur beginning in late spring, and eventually increases in purchases of business equipment will be necessary before the economy can be said to have fully recovered.

February's DRI/WEFA baseline forecast shows the economy strengthening gradually through late summer, then stabilizing at an annual growth rate of about 3.5 percent. For calendar 2002 DRI now projects real GDP to grow at a 1.0 percent annual rate, up noticeably from the 0.4 percent growth rate forecast in November. In 2003, real growth is expected to be at a 4.0 percent annual rate, in November a growth rate of 4.4 percent was projected. The major change in DRI's forecast is that two modestly negative quarters have been replaced by two quarter of 0.2 percent growth.

DRI assigns its February baseline scenario a probability of 55 percent, the same as in November. Unlike November the principle alternative (probability 30 percent) is a more optimistic scenario. A scenario with a second recession beginning in 2003 is assigned a probability of 15 percent.

Members of Minnesota's Council of Economic Advisors and Finance Department Economists agreed that the DRI February baseline forecast reflects the consensus outlook through the end of calendar 2002. Most were less optimistic than DRI about the outlook for 2003. All agree the economy is strengthening, and that while a number of challenges will need to be overcome before the expansion is solidly established, absent further

terrorist incidents or other external shocks, it is reasonable to believe that by the close of 2002 the 4 percent growth rates forecast by DRI can be attained. Council members were split in their views about the risk associated with this forecast. While some believed it likely to prove to be slightly pessimistic, most feared it too optimistic for 2003.



The Council and Finance Department Economists spent considerable time examining the reasons for DRI's weaker than consensus 0.2 percent growth rate for the first quarter of 2002, and comparing the DRI outlook with that of several other forecasters. The comparisons showed that while there is general agreement that the economy will grow during the first quarter of 2002, there is no agreement among national forecasters about the sources of that growth. Specifically, there appear to be particularly wide differences in assumptions about inventory changes, government spending levels, and business investment spending.

Despite the significant differences in outlook for this quarter, the forecasts examined reached very similar conclusions about the level of income and output in mid 2003 and beyond. But, even though there was general agreement about the likely path this economic recovery would follow, Council members cautioned that there is still a significant risk that the expansion could stall before fully recovering, even without an external shock.

As noted earlier, the upswing of the inventory cycle must eventually be accompanied by increases in consumer spending and business investment or economic growth will stall. Slower than anticipated wage growth or an increase in the personal savings rate caused by continuing concerns about job growth could easily restrain consumer spending. In the absence of further increases in consumer spending, business demand for new plant and equipment is likely to continue to languish. Such a scenario would not necessarily lead to another recession, but it would lead to an extended period of sub-par growth and the economy under-performing the current forecast.

Finance Department economists again drew attention to the wide difference between national growth in wages and the growth in Minnesota wages. Based on withholding tax receipts, fourth quarter 2001 wages were more than one percent below fourth quarter 2000 wages, while national wages are reported to have grown by 3 percent. Should national wage estimates be reduced to better reflect lower 2001 bonuses and option activity, forecasts for consumption growth in early 2002 would likely fall. Finance Department economists also noted that withholding collections to date indicate that first quarter 2002 Minnesota wages are also likely to show a decline of more than one percent from the levels observed in the first quarter of 2001.

Council members cautioned state policy makers against assuming that future economic news will continue to be better than that implied in February's baseline economic forecast. State revenues can fall short of forecast even without a recession. If the recovery is only a little less robust than is currently being projected by DRI, further actions will be necessary to bring the 2002-03 budget into balance.

The Council again stressed the importance of maintaining structural balance for 2005, and noted that good financial management also requires there be a plan for restoring the budget reserve as part of any budget solution.

ECONOMIC OUTLOOK

There are signs the recession is ending. But economists will wait until payroll employment and industrial production resume growing before saying a recovery is underway. Both of those critical indicators declined in January. Even if a recovery starts soon, the economy will be weak and vulnerable to unfavorable shocks. Unfortunately, the risks to a recovery have increased during the past several weeks.

The good news is that consumer sentiment and spending are improving. For the last few months, surveys indicate rising sentiment as layoffs slowed. Rising optimism has coincided with increases in household purchasing power from mortgage refinancing, from lower energy prices, and from lower federal withholding rates beginning January 1. As a result, consumers have been willing to spend. The Christmas shopping season turned out better than expected. More recently, auto sales have been surprisingly strong since zero percent financing ended and the *Wall Street Journal* reports spending on other goods seems to be accelerating.

Forecasters are counting on consumers to sustain a weak recovery. The rebound will be tepid and precarious until there is help from business capital spending. That could take time. First, excess inventories must be reduced. Then as consumer demand grows, orders for goods will rise, leading to gains in industrial production, capacity utilization, profits, and ultimately increased business spending. Inventories have been declining and orders appear to be improving, but the exact timing of a pickup in capital outlays is not something economists can predict accurately. DRI assumes that turnaround will take place sometime this fall.

But, while the recession may be ending, there is growing risk of an unfavorable shock. Another act of domestic terrorism or war in the Middle East are still possibilities, and now there is great concern about the accuracy of corporate accounting. The Enron bankruptcy and news that some other large firms may have overstated earnings came at a bad time for investors already nervous about weak profits and seemingly high market valuations.

Rising investor nervousness increases the chance of a sudden stock market correction which could dampen consumer sentiment and spending. And potential inaccuracies in financial statements increase the riskiness of business loans and corporate bonds. That could lead to a sharp increase in long-term interest rates which would force firms to postpone capital projects.

Unsettled Financial Markets

Recent financial news has raised the risk the recovery might stall. Accounting revelations in the wake of the Enron bankruptcy have increased stock market volatility. Whether that will lead to a market downturn is unclear. In the past, the market has often soon forgotten bad news. Some analysts think that will happen again provided no more Enrons appear.

Banks and the bond markets do not forget so often, or so quickly. A *Business Week* article reports that banks are tightening credit standards, cutting some firms off from capital funding sources. And, *The Wall Street Journal* reports that since late January the interest rate spread between investment grade corporate bonds and Treasury issues has increased sharply. The higher rates relative to benchmark Treasuries compensate bondholders for the risk that opaque and possibly inaccurate accounting has overstated profits.

Uncertain Timing

Unless the advance estimate for fourth quarter 2001 real GDP is revised downward, growth appears underway. But, that growth is too slow to create enough jobs to reduce the unemployment rate or restore the pre-recession economy's ability to generate rising real incomes. Full-fledged recovery requires jobs-producing increases in spending on new plants, equipment, and software. Normally, technologies embedded in new capital stock lead to productivity gains, so real wages can rise. Recent productivity gains were strong, but DRI reports those improvements came from reductions in hours worked, not new investment.

Predicting recoveries in business investment spending is not something economists have done well in the past. They can specify the necessary sequence of events, which usually begins with an inventory sell-off, but not the timing. It seems unlikely predictions will be any better this time. Currently, there are wide differences of opinion among forecasters about inventory changes and business spending during the next few quarters.

Inventories have always been a major source of forecast uncertainty. Generally, after a recession firms will not increase capital spending until production and profits rise. And they will not increase production without new orders, which will not come until existing excess stocks are sold. There has been a rapid inventory sell-off which DRI assumes is close to an end because of its huge apparent size. But the sell-off may take longer than expected. No one can be sure how much has been sold, what desired inventory levels are, or how long it will take to reach that point. As articles in the *Survey of Current Business* indicate, inventory data are inaccurate and subject to large revisions.

Once inventories are reduced to desired levels and new orders appear, production increases may not follow as they usually do. Because of the global recession, there is widespread excess capacity and intense competition. And the strong dollar is a great disadvantage for domestic producers. Consequently, DRI believes there is a risk that many new orders will go overseas. In that case, U.S. production and profits may not increase as in a normal recovery, delaying business capital projects.

There are also other uncertainties surrounding the outlook for investment spending. Many believe the information revolution of the 1990's significantly changed the ways business decisions are made. There are indications that many firms restructured in response to the availability of more timely information, but no one yet knows how this

affected desired inventory levels and expected profits needed to justify new plant and equipment.

A Slow, Risky Recovery

Consumer sentiment is improving, but it is likely to remain below pre-recession levels until the unemployment rate starts falling, and strong real income growth resumes. Until consumers believe their jobs are safe and incomes are rising, there is a significant risk they could retrench, aborting the recovery. That is also a likely response to another terrorist attack, or other unforeseen shock.

Even if less unemployment and rising incomes make consumers more resilient, their spending during the recession is likely to lead to a relatively slow recovery, especially during its initial stages. During the past year, real growth in household spending declined, but it did not contract as in previous recessions. That helped make this downturn the mildest on record, but now there is relatively little pent-up demand to fuel a rebound. Weak demand coupled with slow growth in wages has most economists expecting only modest consumer spending, and therefore a tepid recovery that is vulnerable to negative shocks.

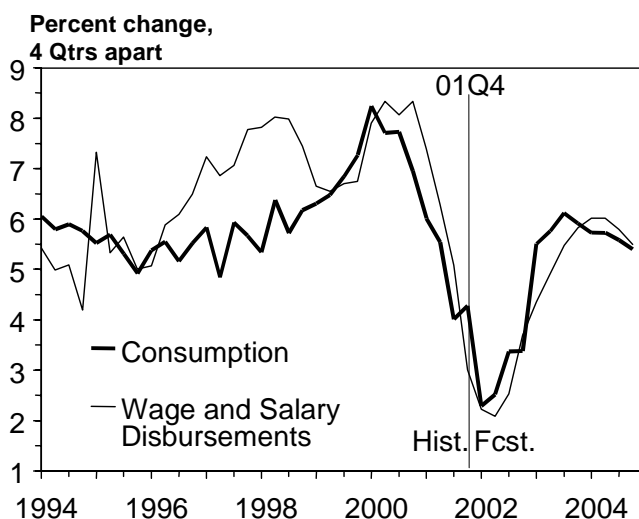
Consumption

Economists generally credit high levels of housing wealth, mortgage refinancing, and monetary easing for consumer spending's strength during this recession. A *Time* magazine article indicates that never before have so many had so much housing equity and a way to turn it into cash. Other analysts note that never before has the Federal Reserve lowered interest rates so aggressively.

Currently, consumers appear ready to sustain a recovery. Fewer layoffs, lower energy prices, and military success in Afghanistan help explain why both the Conference Board and the University of Michigan surveys indicate consumers are gradually becoming more upbeat about the economy several months in the future.

But, most forecasters believe rising optimism is likely to be accompanied by only modest acceleration in real household spending growth. Since they never really curtailed their shopping, consumers have no long list of postponed purchases. Many will also spend modestly because capital gains realizations and profits driven performance compensation have shrunk, and because a heavy debt load is likely to constrain credit card use. As a result, DRI and most other forecasters expect consumer spending to closely follow growth in wage and salary disbursements. Wages growth, though, is expected to be slow for most of the next year because of the soft labor market and the absence of profits driven bonuses.

Consumption Is Expected To Closely Follow Wages



Forecasters generally expect consumer spending to closely follow wages. Should the wage estimates be optimistic, as Finance Department economists suspect, spending may not grow as rapidly as anticipated.

Consumption forecasts based on recent estimates of total wages could prove to be optimistic. Finance Department economists suspect the U.S. Commerce Department has overestimated national wages for 2001, data most forecasters use as a jumping off point for the February forecast. In making those estimates, Commerce did not reconcile with federal withholding collections. That could be an important omission if performance compensation has shrunk as much as anecdotal reports indicate. Should the wage estimates be optimistic, consumption may not grow as rapidly as DRI and other forecasters now expect.

Investment

Recent consumer spending for household goods has been strong because of record home sales. The *Wall Street Journal* reports sales of new and existing houses set a record in 2001, primarily because of record low mortgage rates. According to Merrill-Lynch economists, housing activity during 2001 has been stronger than in any previous recession. DRI and other forecasters think housing is on its way to another good year in 2002.

The struggling industrial sector is a different matter. Increased production is the key to rising capacity utilization, higher profits, and eventually increased business investment spending. But, firms will not increase production without new orders, which will come only when inventories are no longer adequate to meet demand. Most forecasters think that will be soon because they believe excessive inventories have been cleared out by a better than expected Christmas retail season and strong auto sales.

Orders seem to be improving, though so far without apparent impact. In early February, the U.S. Department of Commerce reported that seasonally adjusted factory orders grew in December, the second increase in three months. Although the largest increase was defense-related, non-defense capital goods orders also rose. But, despite more orders, industrial production declined in December, and again in January.

The uncertain relationship between inventories, orders, production, profits, and capital spending decisions is a longstanding problem in business cycle analysis. Now, there are new uncertainties, which could delay capital projects. Some firms, particularly those connected with the travel and hospitality industries, are unsure of what to do because of concerns over when currently depressed business travel will resume. Others, primarily those connected with manufacturing, are unsure when production will be profitable because of global excess capacity and the current broad decline in industrial prices.

Practically all firms are now confronting new uncertainty over what investors and financial markets consider acceptable levels of risk and return. Recently, a *Wall Street Journal* article suggested that historically high market valuations indicate firms have been encouraged to take on higher levels of risk by investors who are better diversified than ever before. If investors were indeed sending a message to be less cautious, that may have ended when the Enron bankruptcy raised concerns about whether corporate profits are overstated under current accounting practices. More accounting revelations or another Enron could lead investors to conclude stocks are overpriced and corporate bonds riskier than previously thought, leading to an abrupt stock market correction and a sharp increase in long term interest rates.

Government

Congress and the President failed to agree on an economic stimulus package before the Christmas recess. In early February, the Senate bill was shelved, apparently ending any chance the \$50 billion package will be passed. Consequently, DRI does not include it in the February Control forecast. That did not have a major impact. Nearly half of the package's cost came from proposed elimination of the corporate alternative minimum tax and faster depreciation, changes which would have increased profits, but not investment in a soft economy.

In the Control forecast, loss of additional consumer demand from the proposed stimulus package's \$16 billion in tax rebates was partly offset by higher projected household spending based on recent improvements in consumer sentiment. Congress is still considering an extension of eligibility for unemployment benefits, which DRI assumes will eventually be enacted. But, relatively little in extended benefits will be paid out if the recession's end is imminent as DRI assumes.

During a recent speech, Federal Reserve Chairman Greenspan indicated that fiscal stimulus of the kind considered before Christmas is no longer needed to ensure a recovery. DRI shares Dr. Greenspan's view, arguing that spending increases built into the fiscal 2002 federal budget will suffice. That appears to be the case since in fourth

quarter 2001, the GDP report indicated real federal spending increased at a 9.5 percent annual rate. And, except for debt service, DRI reports outlays in the first few months of the fiscal year are up at double digit rates compared to the same period last year. Meanwhile, receipts are flat compared to last year once adjustment is made for the shift in federal corporate tax payments from September to October.

International

Foreign trade is unlikely to contribute to the recovery in 2002. Imports will decline because of weak domestic demand, and exports will fall because of the strong dollar and weak overseas economies. Imports are expected to decline less than exports, so the U.S. trade deficit will widen, subtracting from real GDP growth.

There is a risk that recessions underway in Japan, in Latin America, and in Germany will worsen, leading to a wider U.S. trade deficit and slower real GDP growth than DRI now expects. Most of the concern is focused on Japan whose shaky banks threaten international financial stability. If Japan tries to save itself by permitting a sharp decline in the yen as some analysts fear, a widespread devaluation of Asian currencies could follow. That would make U.S. goods much less competitive in a market which constitutes 30 percent of world trade.

Analysts believe the U.S. recession has contributed to the global slowdown. DRI reports the Southeast Asian economies are hard hit because exports to the U.S. are a large part of their GDP. Other overseas recessions are viewed largely as the result of policy failures, including those in Japan, Argentina, and now Germany. Japan and Argentina have failed to accomplish long overdue financial and structural reforms. Germany appears to be the victim of the European Central Bank's failure to lower interest rates aggressively last year.

Monetary Policy

The Federal Reserve Open Market Committee declined to cut interest rates at its January 29-30 meeting, apparently ending the long string of 11 reductions, which began January 3, 2001. During that period, in one of the most aggressive easings ever, the Fed reduced the nominal short-term federal funds rate to 1.75 percent, a 40-year low. Though that easing did not head off the recession, analysts generally agree that low rates greatly reduced the downturn's severity by keeping housing activity and consumer spending unusually strong for a recession.

If the recession is waning, last year's monetary easing now constitutes a very large amount of stimulus which will continue working its way through the system for about the next year. And that stimulus will be augmented by increased federal outlays. Some of those are already in the pipeline and more will be added if the President and Congress agree on a fiscal 2003 budget with the significant spending increases that now seem likely.

Large amounts of monetary and fiscal stimulus are a source of concern even in the current relatively benign inflationary environment. Consequently, DRI expects that once the economy shows clear signs of recovery, the Federal Reserve will begin raising rates, probably by early summer. A major risk is that the Fed or the financial markets will overreact. An overreaction becomes more likely if the economy rebounds more strongly than expected, or if conflict in the Middle East leads to a sharp boost in oil prices.

Inflation

Though last year's decline in energy prices is not expected to resume, DRI expects consumer inflation will remain moderate. For 2002, the consumer price index is expected to rise just 1.4 percent, down from 2001's 2.8 percent. There are several reasons for expecting modest inflation.

Worldwide economic weakness has led to global excess capacity in almost every major manufacturing industry according to DRI. That has led to intense competition, which is expected to drive industrial prices down this year. The U.S. producer price index for finished goods is expected to fall 1.4 percent in 2002 after rising 2.0 percent in 2001. Larger declines are expected for crude and intermediate materials prices.

Forecasters have a benign outlook for labor costs primarily because they expect the unemployment rate to continue rising for several months, reaching about 6.2 percent next fall before beginning a slow decline. During the first half of this year the labor force will grow faster than employment even if the recession ends soon, so the number of unemployed will continue to rise. During the second half, jobs gains will gradually exceed labor force growth, so the unemployment rate begins to decline toward year's end.

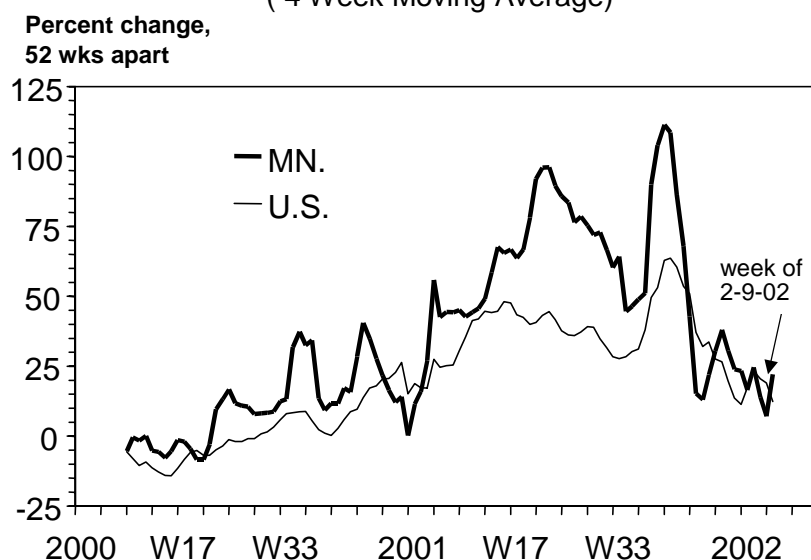
Soft labor markets mean a relatively weak outlook for salaries and hourly pay. At the same time, weak profits will hold down bonuses and employer contributions to retirement plans, and new benefit packages will increase employee contributions for health insurance. That is not good for paychecks, but it also means less cost pressure and lower inflation in the service sector.

MINNESOTA OUTLOOK

Optimistic signs seem more numerous for the national economy than for Minnesota. But, that could be deceptive because many national indicators are not available at the state level including consumer sentiment and spending, and capital outlays. Most of the available state data is labor market information from the Minnesota Department of Economic Security which indicates continuing weakness. There are signs, though, that the situation may soon stop getting worse. Compared to a year ago, initial claims for unemployment compensation show improvement. Preliminary data indicates seasonally adjusted employment increased in January, but that seems to be a statistical anomaly.

Late last year, it was an employer's job market. Economic Security's Job Vacancy Survey released in late January shows that in 2001's fourth quarter there were more job seekers than open jobs, a sharp reversal from one year earlier when there were more unfilled jobs than seekers. The employers' job market continued into 2002 with weekly initial claims remaining above year-ago levels into February. But, the gap between current initial claims and those of a year ago has been closing, suggesting that labor market conditions may soon stop getting worse. A comparable data series for the U.S. shows the same thing, indicating that the national and Minnesota recessions could end simultaneously. An end, though, does not mean conditions are improving. That will have to wait until continuing claims begin to fall.

Weekly Initial Unemployment Claims Show Improvement (4 Week Moving Average)



The gap between current weekly initial unemployment claims and those of a year ago has been closing, so labor market conditions may soon stop worsening. Data for Minnesota and the U.S. shows the state and national recessions could be on track to end at about the same time.

The soft job market is critical to the revenue forecast. Preliminary data show that fourth quarter jobs declined about as forecast last November. However, income tax withholding receipts indicate total nominal wages were less than forecast. Fourth quarter withholding collections now lead Finance Department economists to conclude that nominal wages declined one percent compared to the same quarter one year previously. That is a downward revision from the zero growth expected in November, an outlook based on only October's collections. After analyzing January withholding collections, Finance Department economists believe first quarter 2002 wages also declined about 1.0 percent compared to a year ago, another downward revision.

With those revisions, the recession has now cost between one and two year's normal growth in employment and wages. Finance Department economists note that DRI's outlook for an end to the national recession means Minnesota's downturn is not likely to get worse before a recovery begins. But, the current depth of the state's recession dominates the Minnesota outlook for 2002 and early 2003.

Revised Data for 2001

Lower wage estimates are part of a downward revised starting point for the new forecast. As with every February forecast, incomplete and preliminary data for the previous year forms the point for the 2002-2003 outlook. Finance Department economists believe the preliminary U.S. Department of Commerce estimates of total Minnesota wages for the first three quarters of 2001 are inconsistent with wages reported by employers to the unemployment insurance system. Consequently, data from the Minnesota Department of Economic Security was used to estimate wages for those quarters. No preliminary data on fourth quarter wages is available yet, so the Finance Department model of the Minnesota economy was used to prepare an estimate.

For all four quarters, the wage estimates were adjusted to be consistent with Minnesota withholding collections. As a result of those calculations, Finance Department economists believe fourth quarter 2001 wages declined one percent compared to the same quarter of the previous year, a downward revision from the zero growth expected in November. Less significant downward revisions were also made in November's estimated wages for the second and third quarters of 2001.

For the February forecast, preliminary establishment employment data for all twelve months of 2001 was available from the Minnesota Department of Economic Security. That data confirmed the November forecast's estimates for 2001. The combination of lower wages and the same number of jobs lowered the 2001 estimate for nominal wages per job, the critical starting point for the economic forecast, and the revenue estimates.

Minnesota's Recession and Recovery

Compared with November, February's Minnesota outlook is for a slightly deeper recession and a slower recovery than expected in the national economy. Estimated growth in total wages has been revised to 3.5 percent in 2001, down from 4.0 percent in November. For 2002, Minnesota wages are now expected to increase 2.1 percent, down

from 2.6 percent previously. A significant part of the downward revision reflects the recession's negative impact on wages in 2001 which carries forward into 2002. Compared with November, the slower recovery also reflects a lower forecast for public sector employment.

Minnesota Recovery Trails National Outlook

(Calendar Year Percent Changes)

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Wage and Salary Disbursements				
Minnesota				
November '01	8.3	4.0	2.6	6.1
February '02	8.3	3.5	2.1	5.1
United States				
November '01	8.2	5.5	2.6	5.3
February '02	8.2	5.4	2.6	5.1
Non-Farm Establishment Employment				
Minnesota				
November '01	2.2	0.3	-0.6	1.4
February '02	2.2	0.3	-0.8	1.2
United States				
November '01	2.2	0.4	-0.4	1.0
February '02	2.2	0.4	-0.4	1.6

Shortly after reaching bottom, most major sectors will begin growing. There are three sectors where recovery will be delayed. State and local government employment will decline until fall 2002 and not begin a recovery until mid-2003 at the earliest. Durable goods manufacturing will continue to slowly lose jobs until toward the end of 2002. Construction employment will gradually decline until mid-2003.

Pressures on public sector budgets are reflected in a forecast for a slow decline in state and local government employment. It is not possible to predict exactly where the job losses will occur. That will depend on how state and local agencies and schools manage through the forecast horizon.

There are multiple reasons to expect a delayed recovery for Minnesota's durable goods sector. Relatively little of widely expected increases in defense production will occur here. Also, virtually all manufacturing industries are feeling the impact of declining industrial goods prices, which reflects global overcapacity and intense international competition. For exporters, the competition is exacerbated by the strong dollar, which makes Minnesota made goods relatively expensive. Finally, much of the recent job loss in durables manufacturing is concentrated in computers and electric machinery. That is a consequence of the burst tech bubble, and ongoing strong productivity gains.

Despite difficulties, Minnesota's durables sector continues to outperform its national counterpart as indicated by a generally rising share of U.S. durables jobs in both history and forecast. That trend is expected to continue as defense expenditures rise.

Minnesota construction employment is forecast to slowly decline through mid-2003 as office and other commercial building projects currently underway are finished and fewer new ones undertaken. A recent United Properties report indicates there are no new multi-tenant office buildings in the pipeline for 2003 delivery. That reflects the current downturn in private commercial building, which will be partly offset by a strong housing sector and by federal TEA-21 highway repair and construction. Recent news of a possible reduction in federal highway funds for 2003 came too late to be considered for the forecast. If federal highway funds are cut, a construction sector recovery in 2003 will depend almost entirely on a pickup in commercial construction.

Forecasting Minnesota Wages

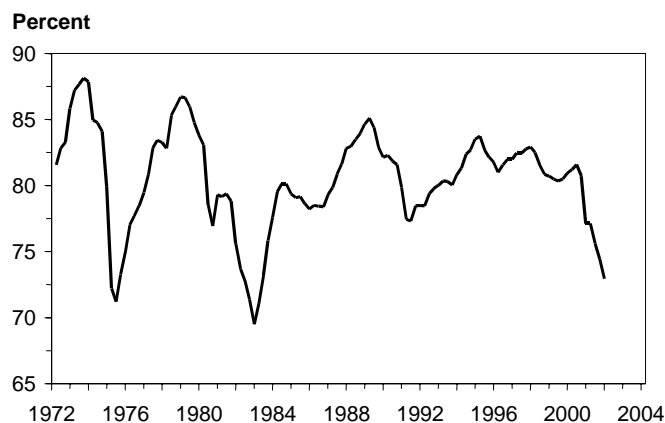
Finance Department economists estimate that both fourth quarter 2001 and first quarter 2002 total wages declined one percent from year-earlier levels. Part of that decline is attributable to jobs lost in the recession. But, anecdotal evidence reported in press articles indicates that performance based compensation has also shrunk significantly. Finance Department economists currently have a research project underway which eventually may let them make some inferences about the magnitude of changes in bonuses and stock options exercised between 2000 and 2001.

Inferences are needed because direct observation of performance compensation is not possible. U.S. Department of Commerce data on total Minnesota wages is based on employer reports to the unemployment insurance system. Employers report bonuses when paid, the value of stock options when exercised, salaries, and hourly pay as a single lump sum. No information concerning the different kinds of compensation is reported. Consequently, Finance Department economists can only forecast Minnesota total wages as a lump sum.

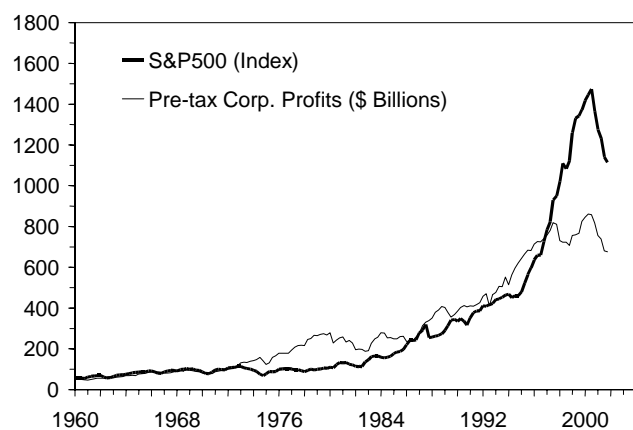
The lump sum forecast contains significant implicit assumptions. There is no information which can be used to forecast explicitly how soon lost bonuses will be restored or when new stock options will be granted. Also, there is no reliable information indicating how large the existing backlog of existing unexercised stock options is, and when they might be exercised and reported as wages. A recent *New York Times* article reports on a survey of 1500 large firms showing that in many industries it is not unusual to have unexercised options amounting to 10-20 percent of outstanding stock. Though those options are widely thought to be worthless now because of the weak stock market, no one knows what prices are needed to make them exercisable. All these considerations increase the uncertainty surrounding the wage forecast.

Selected National Economic Indicators

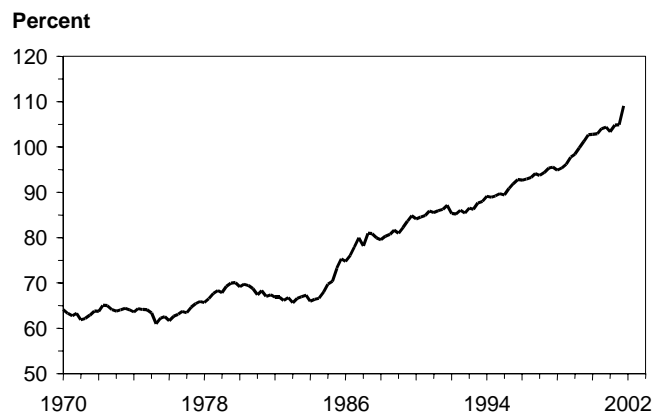
Manufacturing Capacity Utilization



Corporate Profits and the Stock Market

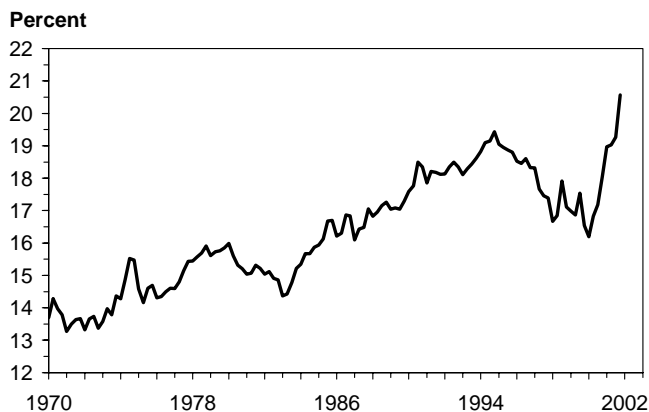


Household Financial Liabilities As a Share of Disposable Income

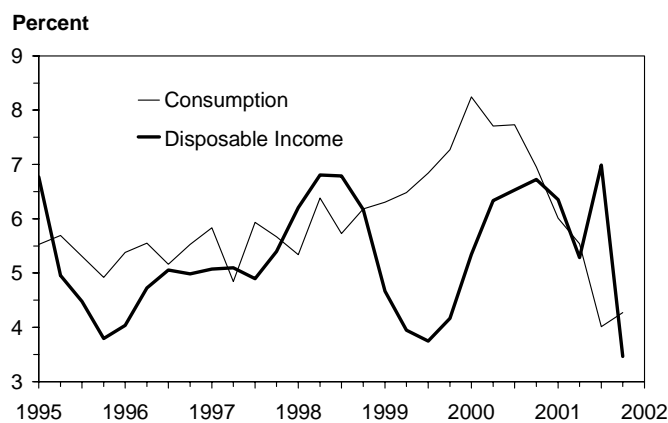


Selected National Economic Indicators

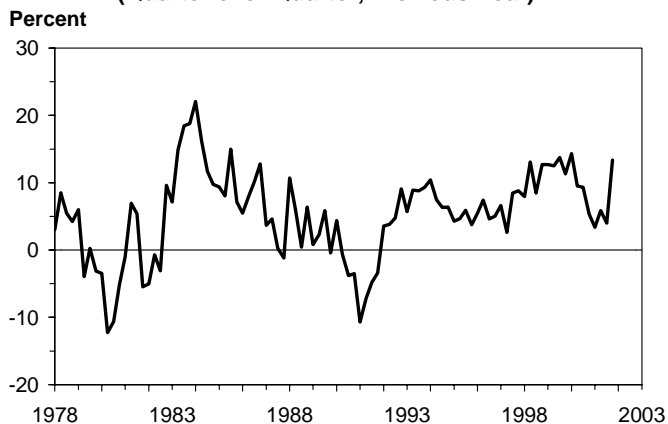
Household Financial Liabilities As a Share of Net Worth



Disposable Income & Consumption (Quarter Over Quarter, Previous Year)

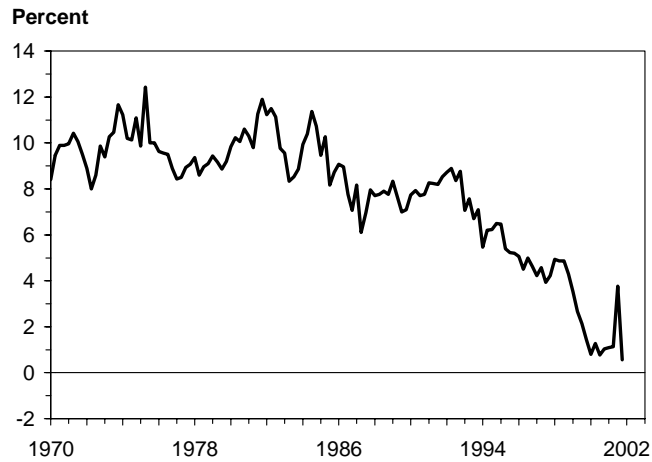


Growth in Real Consumer Durables Spending (Quarter over Quarter, Previous Year)

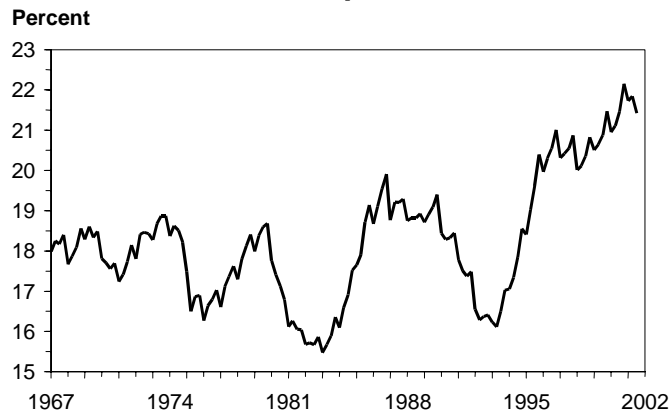


Selected National Economic Indicators

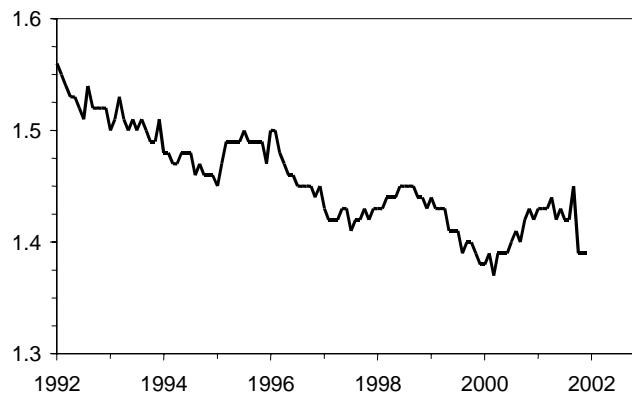
Saving as a Fraction of Disposable Income



Installment Credit Outstanding As a Percent of Disposable Income

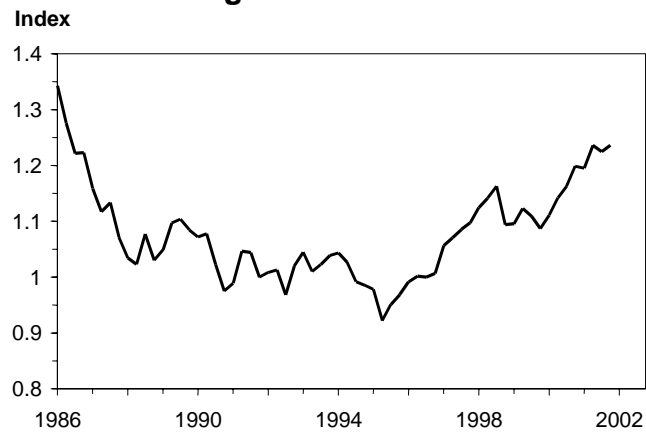


Manufacturing and Trade Inventory to Sales Ratio

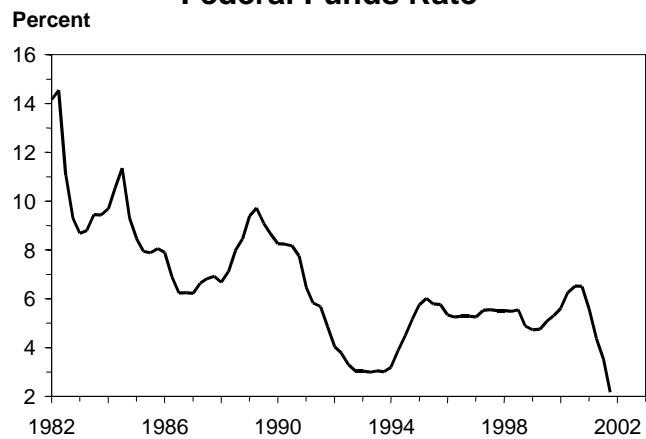


Selected National Economic Indicators

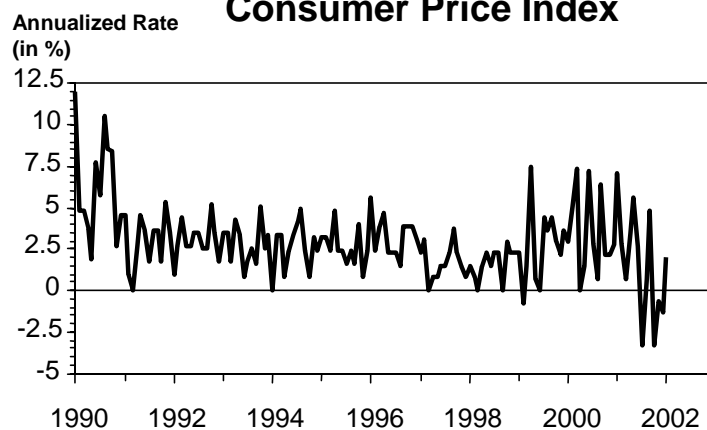
Trade-Weighted Value of the Dollar



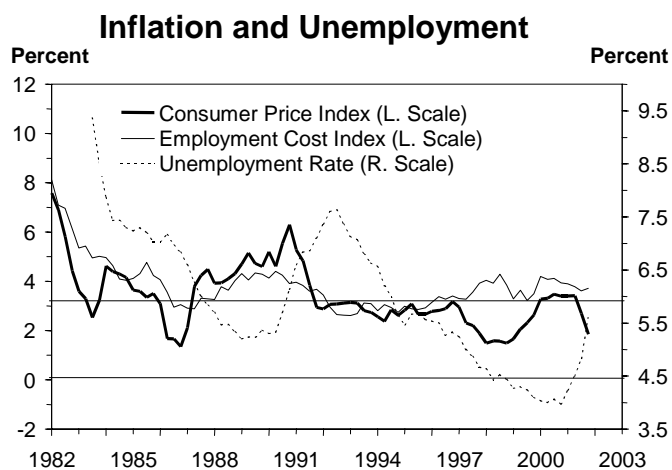
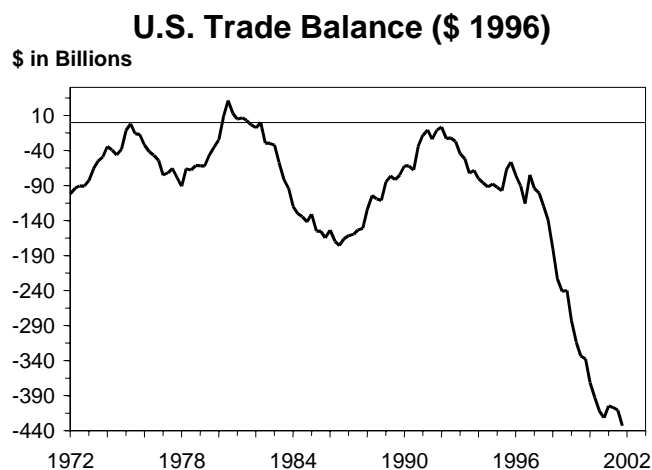
Federal Funds Rate



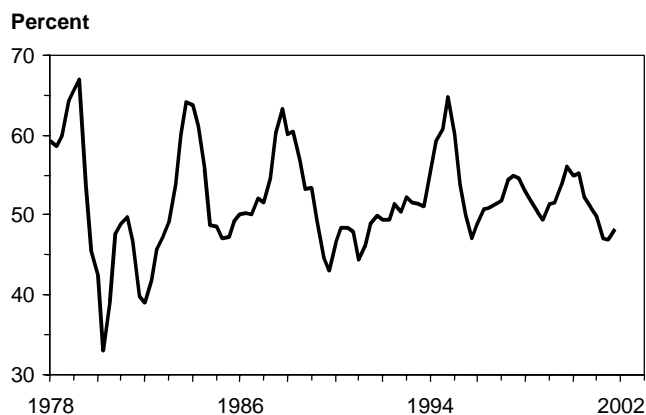
Consumer Price Index



Selected National Economic Indicators

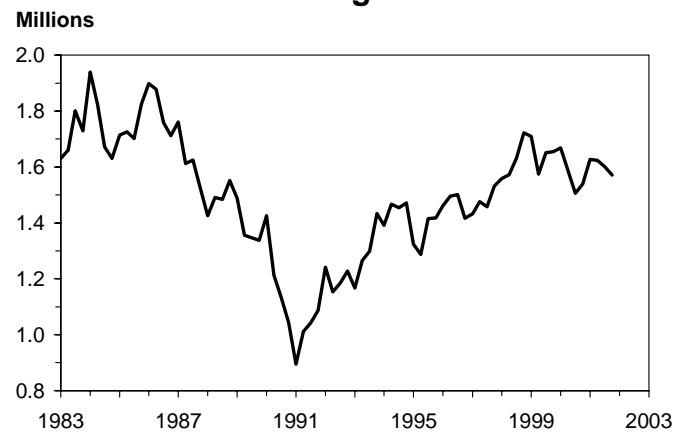


Proportion of Companies Receiving Slower Deliveries

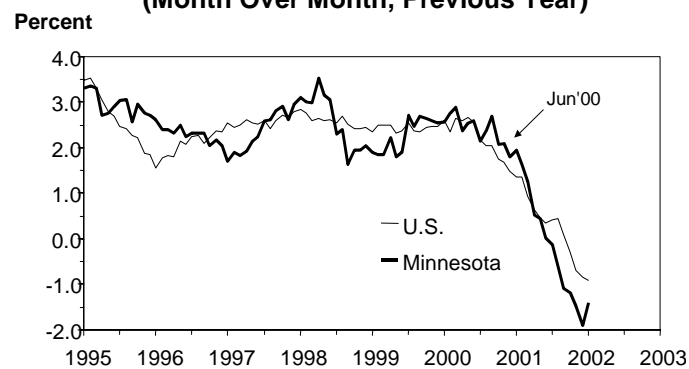


Selected National Economic Indicator

Housing Starts



Minnesota and U.S. Jobs (Month Over Month, Previous Year)



FY 2002-03 Budget Summary FY 2004-05 Planning Estimates

Projected Deficit of \$2.289 Billion now Forecast for FY 2003

Forecast revenues for the current biennium have been reduced by \$306 million, while estimates for transfers, dedicated revenues and other resources have increased by \$6 million leaving a net revenue decline of \$300 million. Spending for the biennium has increased \$36 million. These changes combine to increase the forecast deficit from the \$1.953 billion forecast in November 2001 to the \$2.289 billion shortfall now expected by June 30, 2003.

Comparison: FY 2002-03 Budget (\$millions)

	<u>Nov Forecast</u>	<u>Feb Forecast</u>	<u>Difference</u>
Beginning Balance	\$ 1,574	\$ 1,574	\$ 0
Revenues	25,412	25,106	(306)
Other Resources	42	48	6
Expenditures	<u>27,806</u>	<u>27,842</u>	<u>36</u>
Balance before Reserves	(778)	(1,114)	(336)
Cash Flow Account	350	350	0
Budget Reserve	653	653	0
Tax Relief Account	158	158	0
Other Resources	<u>14</u>	<u>14</u>	<u>0</u>
Available Balance (Deficit)	<u>\$(1,953)</u>	<u>\$(2,289)</u>	<u>\$(336)</u>

Lower Tax Receipts Account for Most of the Increase in the Deficit

A \$403 million reduction in forecast income tax receipts accounts for the net decline in estimates for the general fund's five major tax sources. Accompanying the reduction in income taxes was a \$46 million reduction in expected corporate tax receipts. Expected sales taxes show a \$94 million increase due to an adjustment delaying by one year the cost of eliminating the June sales tax acceleration enacted in 2001 due to an error in drafting the legislation. Without this change sales tax estimates would be nearly \$28 million below November's forecast. Motor vehicle sales tax receipts are forecast to \$27 million higher during the biennium, and the statewide property levy which is amount specific and adjusted only for forecast inflation, \$2 million lower.

Spending Estimates for the Biennium are Largely Unchanged

Forecast spending for the biennium is now expected to be \$27.842 billion, a net \$36 million increase from November. This amount represents less than a 0.1 percent change in total spending. Higher spending for health care added \$64 million to total spending and intergovernmental aids added \$18 million. These increases were largely offset by \$28 million in lower estimates for education finance, \$10 million in health and human services savings, and a net \$8 million reduction in all other spending areas.

FY 2004-05 Planning Estimates Highlight Widening Budget Gap

The forecast includes planning estimates for the next biennium. These estimates are materially different than the forecast for the current biennium. The distinction is based primarily on the difference in approach and assumes greater accuracy of shorter term forecasting for FY 2002-03. For the current biennium a budget has been enacted, for the next biennium no budget is in place.

Planning estimates of current law revenues and expenditures for FY 2004-05 are presented to help decision-makers identify longer-term consequences of budget decisions. Revenue planning estimates are based on DRI's February control for calendar 2004, and long term trend growth rate for 2005. Expenditure estimates assume that current laws and policies are updated for caseload, enrollment, and other forecast variable in major program areas. In addition to this current law "baseline" forecast, the planning estimates include a net amount for estimated inflation expected during the period. The current FY 2004-05 expenditure planning estimates include estimated inflation of 2.5 percent per year based on the February DRI forecast. This is unchanged from the rate expected in the November forecast.

These planning estimates do not reflect Governor's recommendations or legislative actions to reduce the deficit forecast for the current biennium. Since the forecast makes no assumption about possible budget solutions, the display of planning estimates for FY 2004-05 highlights the structural balance or deficit — that is the difference between likely on-going revenues and on-going spending.

FY 2004-05 Planning Estimates

(\$ millions)

	<u>November Forecast</u>	<u>February Forecast</u>	<u>Difference</u>
Revenues			
Non-Dedicated	\$28,846	\$28,178	\$(668)
Other Resources	<u>200</u>	<u>197</u>	<u>(3)</u>
Total Revenues	29,046	28,375	(671)
Spending			
Baseline Forecast	30,455	30,462	7
Estimated Inflation	<u>1,127</u>	<u>1,127</u>	<u>0</u>
Total Spending	31,582	31,589	7
Difference / Structural	<u>\$(2,536)</u>	<u>\$(3,214)</u>	<u>\$(678)</u>

The structural gap in the FY 2004-05 planning estimates has widened from the forecast in November. In November a \$1.2 billion annual structural shortfall was projected for both FY 2004 and FY 2005. The structural gap is now expected to be \$1.6 billion per year. Compared to November, projected revenues for FY 2004-05 have been reduced by \$671 million, while spending has increased \$7 million. The reduction in projected revenues primarily reflects the significantly lower base of revenues expected for the current biennium for state income, sales, and corporate taxes carried through to the following biennium. Adding to that decline is a reduction in sales taxes of \$130 million from the one year delay to FY 2004 in the elimination of the June sales tax acceleration.

While the total change in spending is marginal, the impact of changes by functional spending categories reflects FY 2002-03 experience. Higher spending for Health Care added \$43 million, while Intergovernmental Aids increased nearly \$17 million. A \$53 million reduction in Education Finance estimates offsets most of this increase, while all other spending areas show little net change.

Revenue Forecast FY 2002-03

Current general fund resources for the 2002-03 biennium are now forecast to total \$25.154 billion, down \$300 million (1.2 percent) from November's estimates. The national economic recession of 2001 appears likely to be the mildest on record, but Minnesota's economy and the economies of other Midwestern manufacturing states bore a disproportionate share of the national decline. Payroll employment in Minnesota fell by more than 1.4 percent between March and December 2001, the seventh worst performance of the 50 states. Nationally, payroll employment fell by just 0.9 percent.

Weaker than projected collections lowered the base level for both the income and sales tax. Consequently, the revenue outlook for the biennium is weaker, even though the economic outlook for early 2002 has improved slightly. That modest improvement in the economic outlook was not enough to overcome starting from a lower base. In addition, February's Control forecast for real economic growth in fiscal 2003 is now projected to be slightly slower than that used in November's forecast.

FY 2002-03 Revenue Forecast

(\$ millions)

	<u>FY2000-01</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2002-03</u>
Individual Income Tax	\$11,472	\$5,737	\$6,051	\$11,788
Sales Tax	6,135	3,713	3,866	7,579
Corporate Tax	1,529	531	625	1,156
Motor Vehicle Sales Tax	1,087	418	274	693
Statewide Property Levy	<u>0</u>	<u>296</u>	<u>595</u>	<u>891</u>
Five Major Taxes	20,223	10,695	11,411	22,106
Other Revenue	2,483	1,372	1,327	2,699
Tobacco	<u>235</u>	<u>150</u>	<u>152</u>	<u>301</u>
Net Non-dedicated	22,941	12,216	12,890	25,106
Other Resources	<u>892</u>	<u>-38</u>	<u>86</u>	<u>48</u>
Current Resources	\$23,833	\$12,178	\$12,975	\$25,154

State revenues through the end of January were \$69 million (2.1 percent) below levels forecast in November. Withholding tax receipts were down \$41 million (3.2 percent) during the months of November, December and January, and gross sales tax receipts were \$14 million (1.4 percent) below forecast over the same period. Even though November's forecast assumed a 25 percent decline in capital gains realizations in tax year 2001, fourth quarter 2001 estimated tax payments were \$66 million (16.7 percent) below forecast.

Revenues from the five major taxes are now projected to fall short of November's forecast by \$330 million. The majority of that shortfall comes in the individual income tax where the forecast was reduced by \$403 million. While the sales tax showed a gain, that gain was entirely due to a change in the expected effective date for the elimination of the June accelerate sales tax program. Without that adjustment, the 2002-03 forecast would have shown a shortfall of \$28 million. There were smaller declines in the forecast for the corporate income tax, and the statewide property levy. The motor vehicle sales tax forecast was increased slightly. Other tax and non-tax revenues are expected to increase by \$30 million.

Individual Income Tax

Individual income tax receipts for the 2002-03 biennium are now forecast to total \$11.788 billion, down \$403 million from November's estimates. Lower forecasts for both wage and non-wage income, and an increase in projected deductions combined to account for more than \$260 million of the decline in revenues. A lower starting point for tax year 2000, reductions in taxes paid by fiduciaries and partnerships, and other technical changes accounted for the remainder of the shortfall.

Withholding tax receipts indicate that fourth quarter wages in Minnesota fell more than anticipated, and the weakness in Minnesota wages is continuing in the first quarter of calendar 2002. Through mid-February, fiscal year withholding tax receipts were 1.5 percent below levels observed one year earlier. Minnesota wages are now believed to have fallen by 1.0 percent from year earlier levels in the fourth quarter of 2001, and are projected to remain 1.0 percent below year earlier levels in the first quarter of 2002 as well. These are the first quarters in at least 40 years in which wages have declined from year earlier levels. While recession related reductions in employment and hours worked explain some of the weakness, the absolute decline can only be due to significantly lower bonuses and fewer stock options being exercised.

The outlook for future wage growth in Minnesota has also dimmed since November. Defense spending is now expected to be the source of much of the economic growth projected for the next two years, and Minnesota's share of national defense spending is small. Expected cutbacks in public sector employment also contribute to the weaker estimates. Forecast wage growth in 2002 and 2003 has been reduced to 2.1 percent and 5.1 percent, respectively. In November wage growth rates of 2.6 percent and 6.1 percent were anticipated. The revised forecast for Minnesota wage growth reduced expected income tax receipts by more than \$100 million.

Since fourth quarter estimated tax payments more than 16 percent below the level forecast in November, the forecast for non-wage income--particularly capital gains, IRA distributions, and pension income -- had to be lowered. Capital gains realizations are now thought to have declined by 32 percent in 2001. Realizations are expected to decline an additional 3 percent in 2002, and then grow by 20 percent in 2003. November's forecast called for a decline of 5 percent in 2002 and an increase of 20 percent in 2003. This forecast's estimated drop in capital gains in tax year 2001 is greater than that used

by the Congressional Budget Office in their January 2002 projections. As has been noted in previous forecasts, capital gains are extremely volatile and have shown double digit, year-to-year declines during past recessions.

The weaker stock market in 2001 and revised assumptions about the number of taxpayer adjusting their IRA distribution rates reduced the base for taxable IRA distributions. Pension income and interest income were also reduced, consistent with lower estimated tax payments. In total, reductions in the forecast for non-wage income reduced the individual income tax forecast by more than \$100 million from November's estimate. Consistent with lower current collections and a slower outlook for equity growth, income taxes paid by fiduciaries were reduced by \$20 million for the biennium.

Preliminary analysis of tax year 2000 tax returns showed itemized deductions at a higher level than forecast in November. The higher deductions reduced the income tax forecast by about \$50 million.

Final income tax liability for tax year 2000, as reported on the Minnesota Department of Revenue's processing report, was lower than forecast in November. This reduced the starting point for the tax year 2001 forecast and all subsequent forecasts. The total impact of that change was \$80 million for the biennium. Other material changes to the forecast included a reduction in projected non-resident partnership and S-Corp payments of \$20 million, reflecting lower receipts for tax year 2000, and a \$20 million reduction in fiscal year 2002 receipts due to lower than anticipated final payments on tax year 2000 returns. FY 2003 estimated payments were reduced by \$20 million to reflect a forecast decline in the proportion of taxable income coming from non-wage sources.

There is more than the typical uncertainty around this income tax forecast. Estimates of the decline in capital gains realizations for 2001 vary widely, and most other forecasts expect substantially larger declines in 2001 and 2002 than are projected in this forecast. The actual decline for tax year 2001 can only be inferred from estimated tax payments. Actual values will not be available until next year when a sample of processed tax year 2001 returns is available. Withholding collections in the few days following completion of the income tax forecast indicate that the decline in first quarter wages could be greater than projected in this forecast. It is, however, possible that a significant number of taxpayers have changed their withholding. In that case, our wage estimates would be understated, and expected refunds would fall.

Sales Tax

Net sales tax collections in the 2002-03 biennium are now expected to equal \$7.586 billion, \$94 million (1.3 percent) more than projected in November after adjusting for a change in the effective date for the elimination of the June accelerated sales tax payment. That change increased FY 2003 revenues by \$122 million, but reduced revenues in FY 2004 by \$130 million. In the absence of the revenue gained from that change in assumption about the June acceleration the forecast for gross sales tax revenues would have fallen by \$28 million. Projected sales tax refunds were increased by \$5 million.

Under current law, in months other than June and July, most Minnesota firms must remit sales taxes collected by the 20th of the month following the month of the sale. In June, however, firms remitting over \$120,000 in a fiscal year are required to remit their normal payment, plus an additional payment equal to 62 percent of their expected June collections. Firms making that accelerated payment are then excused from remitting sales taxes in July. Their August payment is equal to the remainder of their June collections and their total sales tax collections for July.

The 2001 Legislature eliminated the June acceleration. But, while legislative intent was clearly that June 2002 be the last month in which the accelerated payments be made, the statutory language approved was sufficiently ambiguous about the effective date that a clarification of the statute was deemed necessary. Since this forecast is based on current law, the elimination of the June accelerated payment is now assumed to occur in 2004. Because the November forecast assumed that the last accelerated payment would be made in June 2002, this change in assumptions yields a one time increase of \$122 million for the 2002-03 biennium and a reduction of \$130 million in FY 2004.

DRI's current forecast is mildly more optimistic for the remainder of fiscal 2002. For example, consumer durable spending in Minnesota is no longer expected to decline, as it was in November. Now consumer durable spending is projected to grow at an annual rate of 0.2 percent. But, since gross sales tax receipts for November, December, and January were \$14 million below levels projected in November, that growth comes from a lower sales tax base. The improved economic outlook is not sufficient to lift FY 2002 sales tax revenues above levels forecast in November. In fiscal 2003, the sales tax base grows at a slightly slower rate than projected in November, further reducing the projected sales tax receipts compared to November's forecast.

After considering fourth quarter e-commerce sales data reported by the Census Bureau, it was determined that no adjustments to the forecast were necessary for future revenue losses due to increased internet sales.

The loss of a court case involving a sales tax exemption produced an increase of \$18 million in fiscal 2002 sales tax refunds. Ongoing receipts also were reduced consistent with the court's decision.

Corporate Franchise Tax

Net corporate franchise tax receipts for the 2002-03 biennium are now estimated to total \$1.156 billion, \$46 million (3.8 percent) less than previously projected. Current receipts continue to be well below the level that would be projected based on the level of profits reported in the national income and product accounts. As in November, a lower estimate for corporate profits was used to correct for the difference between actual receipts and projected receipts. Values for succeeding quarters were then computed using the same growth rate as in DRI's February Control forecast for before tax corporate profits. A correction to the allocation of estimated tax payments for non-residents from partnerships

and S corporations reduced corporate franchise taxes by \$44 million. The corporate franchise tax remains the most volatile of all Minnesota taxes.

Motor Vehicle Sales Tax

General fund receipts from the sales tax on motor vehicles are now forecast to total \$693 million, \$27 million (4.1 percent) more than was forecast in November. Collections for the past three months have exceeded forecast by \$26 million, and that additional revenue was recognized in the forecast. Although the availability of zero interest rate financing undoubtedly moved some sales from spring, 2002 into the fourth quarter of 2001, auto sales through January continue to exceed forecast. DRI expects light vehicle sales to be at the 15.4 million unit level during 2002, up slightly from November's projections. For 2003, sales are anticipated to be at a 16.9 million unit pace.

Other Revenues

Other tax and non-tax revenues, including the statewide property tax levy are expected to exceed November's forecast by \$28 million. The forecast for most of these minor revenue sources changed only slightly. Expected estate tax revenues, insurance gross premiums tax revenues, and regional treatment center collections each increased by \$10 million. To reflect the most recent payment experience expected tobacco settlement revenues were reduced by \$4 million.

Revenue Planning Estimates FY 2004-05

Current resources for the 2004-05 biennium are now projected to total \$28.375 billion, \$3.222 billion, (12.8 percent) more than forecast for the 2002-03 biennium, but \$671 million less than forecast in November. The five major revenues are expected to grow by an average of 13.2 percent, despite a drop in motor vehicle sales tax revenues due to completion of the phase in of the dedication of 32 percent of those collections to the Highway User Tax Distribution Fund. Under current law individual income tax receipts grow by 14.5 percent from levels forecast for the 2002-03 biennium and sales tax are 10.1 percent greater than forecast for the 2002-03 biennium.

FY 2004-05 Revenue Planning Estimates

(\$ millions)

	<u>FY2002-03</u>	<u>FY2004</u>	<u>FY2005</u>	<u>FY2004-05</u>
Individual Income	\$11,788	\$6,543	\$6,953	\$13,495
Sales	7,579	3,997	4,347	8,344
Corporate	1,156	690	704	1,394
Motor Vehicle Sales	693	284	286	570
Statewide Levy	<u>891</u>	<u>605</u>	<u>621</u>	<u>1,226</u>
Five Major	22,106	12,119	12,910	25,029
Other Revenue	2,699	1,365	1,404	2,769
Tobacco	<u>301</u>	<u>189</u>	<u>191</u>	<u>380</u>
Net Non-dedicated	25,106	13,673	14,505	28,178
Other Resources	<u>48</u>	<u>99</u>	<u>99</u>	<u>197</u>
Current Resources	\$25,154	\$13,772	\$14,604	\$28,375

These baseline revenue planning estimates are not explicit forecasts, they are simply extrapolations of projected trends in the economy. Even small deviations from the assumed trend when compounded over five years will produce sizeable changes in revenues. Because of the way these estimates are constructed any change in the base level of revenues for fiscal 2003 will be reflected in the revenue planning estimates for 2004 and 2005. Other things equal, stronger than anticipated revenue growth in fiscal 2002, or fiscal 2003 will carry forward and add significantly to revenues in the 2004-05 biennium. Similarly, should the economy grow more slowly than forecast during the next two years the revenue outlook for the 2004-05 biennium will deteriorate.

The revenue planning estimates are not a guarantee of future revenues. They are only a guide to the level of future revenues. No one can forecast the economy five years into the future. If the economy is as strong or stronger than DRI projects through 2004, and if

projections of capital gains realizations for tax years 2001, 2002, and 2003 are not too optimistic, these planning estimates are likely to slightly understate actual revenues in 2004 and 2005. But, if the economy fails to perform at the level assumed in the DRI's February 2002 Control forecast or if capital gains realizations are below forecast levels, the planning estimates will significantly overstate future revenues. Actual revenues could exceed or fall short of the planning estimates by \$1.5 billion or more, depending on the economy's performance during the next 4 years.

As in November, estimates of revenues for fiscal 2004-05 revenues were based on DRI's current Control forecast for key elements of the tax base in the 2003 and 2004 calendar years. For calendar 2003 DRI now projects real GDP growth at a 4.0 percent annual rate, down 0.4 percent from November's projected growth rate of 4.4 per cent. A 3.9 percent real GDP growth rate was used for calendar 2004, up 0.1 percent from November's assumption. Calendar year 2005 growth rates were obtained by using average annual nominal growth rates consistent with a 5.2 percent annual growth rate for nominal GDP. The implicit real GDP growth rate assumed (3.2 percent) is the same as is used in current Congressional Budget Office projections for 2005 through 2007.

The individual income tax estimates were prepared using the House Income Tax Simulation Model. Assumed filer growth in Minnesota was consistent with average national employment growth of 2.1 percent in 2004 and 1.5 percent in 2005. A single growth rate was applied to all elements of income and all individual itemized deductions. Each of those items was assumed to grow at the growth rate of taxable personal income (the combination of wages and salaries, proprietors' incomes, dividends, interest, and rents) consistent with the assumed nominal GDP growth rate. Taxable personal income growth rates of 5.8 percent in 2004 and 5.3 percent in 2005 were used. Calendar year income tax liabilities were converted into fiscal year revenues using the same proportions as forecast for 2003.

Future sales tax revenues and motor vehicle sales tax revenues were estimated using growth rates consistent with the nominal GDP growth assumed for the year in question. For the sales tax percentage growth rates for each of 14 broad categories of items in Minnesota's sales tax base were computed, and the sum of the weighted growth rates was used as a measure of the expected growth in the sales tax base for 2004 and 2005. Fiscal year corporate tax receipts were estimated to grow at the same rate as the previous calendar year's national before tax corporate profits. Planning estimates for other tax and non-tax revenues were prepared by extrapolating existing trends.

Expenditure Forecast FY 2002-2005

FY 2002-03 Spending Shows Little Change

Forecast expenditures for FY 2002-03 show little net change from November forecast estimates. Spending has increased \$36 million, or 0.1 percent, from November estimates. Total spending for the biennium is now expected to be \$27.842 billion.

Current Biennium Forecast Change (\$ millions)

	November Forecast	February Forecast	Difference
Education Finance	\$11,147	\$11,119	(28)
Higher Education	2,853	2,853	0
Intergovernmental Aids	2,847	2,865	18
Health Care	4,648	4,712	64
Health & Human Services	2,080	2,070	(10)
Environmental Resources	540	540	0
Economic & Workforce Development	398	398	0
Public Safety & Corrections	965	969	4
Transportation	437	437	0
General Government	1,192	1,187	(5)
Debt Service	608	608	0
Transportation Projects	19	19	0
Estimated Cancellations	(20)	(28)	(8)
Subtotal-Major Spending Categories	27,714	27,749	35
Dedicated Expenditures	92	93	1
Total Expenditures & Transfers	\$27,806	\$27,842	\$36

The net increase in forecast spending is attributed to a \$64 million increase in Health Care spending and an \$18 million increase in forecast Intergovernmental Aids. These increases, however, are in part offset by a \$28 million reduction in Education Finance, a \$10 million reduction in Health and Human services, and an \$8 million net reduction in all other spending areas.

FY 2004-05

Compared to November estimates, projected spending for FY2004-05 shows little change. Spending has increased a total of \$7 million, .02 percent, from earlier estimates. Minor increases in the estimates for Health Care and Intergovernmental Aids are largely offset by a reduction in Education Finance estimates.

2004-05 Planning Estimates

(\$ millions)

	<u>November Forecast</u>	<u>February Forecast</u>	<u>Difference</u>
Education Finance	\$12,765	\$12,713	(52)
Higher Education	2,955	2,955	0
Intergovernmental Aids	3,081	3,098	17
Health Care	5,395	5,438	43
Health & Human Services	2,178	2,178	0
Environmental Resources	540	540	0
Economic & Workforce Development	363	363	0
Public Safety & Corrections	1,000	1,000	0
Transportation	168	168	0
General Government	1,261	1,261	0
Debt Service	638	638	0
Capital Projects	15	15	0
Estimated Cancellations	(20)	(20)	0
Estimated Inflation	1,127	1,127	0
Subtotal-Major Spending Categories	31,468	31,474	6
Dedicated Expenditures	114	115	1
Total Expenditures & Transfers	\$31,582	\$31,589	\$7

The estimated impact of inflation during the FY2004-05 planning period has not changed. Planning estimates continue to assume 2.5 percent inflation per year based on February DRI forecast estimates. With the small change in total baseline spending and no change in the forecast rate of inflation, there is no change in the amount of estimated inflation in the expenditure planning estimates.

Education Finance**Education Finance Estimates Reduced by \$28 million for FY 2002-03**

Spending on education finance is now projected to total \$11.119 billion in FY2002-03, a decrease of \$28 million from November. The most significant decreases occur in the

general and special education programs. Although actual FY2001 student counts are 198 higher than those used for the November forecast, with an average daily membership of 854,055 students statewide, a change in the mix of students and other factors result in an overall decrease in spending for FY2002-03.

FY 2002-03 K-12 Education Forecast is \$17 Million Lower

The general education program increased by \$10 million in FY2002-03. About \$9 million of this amount reflects a shift of the final payment for FY2001 entitlements into FY2002. Other increases are driven by additional new referendum elections not reflected in the November forecast, with increases offset by smaller decreases in Limited English Proficiency, Training and Experience revenue, and lower basic general education aid due to charter schools that do not provide transportation services.

Reductions also occurred in nonpublic pupil aids (\$2 million), special education excess costs (\$22 million), and health and safety (\$2 million) programs. Decreases in nonpublic pupil costs reflect lower than anticipated costs for textbooks and counseling services. Actual cost increases of 5.7 percent for the special education excess cost program were lower than the 7.8 percent growth rate projected in November. About \$7 million of this change can be attributed to correcting inappropriate claims by districts. In addition to a decrease in the number of districts qualifying for health and safety aid, higher projected property values led to a lower aid/levy ratio than projected in November.

Estimated spending for family and early childhood programs decreased by less than \$2 million from the November forecast. The decrease is primarily due to a reduction in the number of adult students qualifying for Adult Graduation Aid in FY2001 from the levels projected in November. The forecast reflects substantial anticipated increases in Adult Graduation Aid for FY2002 due to the economic downturn. More moderate rates of growth are anticipated in FY2003.

Updated information for the market value homestead credit in school intergovernmental aids reduced estimates by \$10 million.

FY 2004-05 Planning Estimates Show Little Underlying Change

Total spending in education finance is expected to be \$52 million lower than projected in November, with reductions of \$23 million in K-12 programs, \$2 million in family and early childhood programs, and \$27 million in school intergovernmental aids.

General education estimates remain largely unchanged in FY2004-05. Decreases in compensatory revenue (\$6 million) and transportation sparsity (\$2 million) offset increases in basic education (\$3 million), alternative attendance (\$3 million), and referendum aid (\$2 million).

Health Care

FY 2002-03 Costs Rise \$64.5 Million

Estimates for Health Care spending in the current biennium are now expected to be \$64.5 million higher (1.4 percent) than was estimated in November. Most of this change is attributable to two programs within Medical Assistance that provide community-based services as an alternative to institutional care. In total, Medical Assistance Long-Term Care Waivers are projected to be \$54 million higher than earlier figures.

The forecast for the Waiver for Persons with Mental Retardation and Related Conditions (MR/RC Waiver) has risen by \$38 million since November. Two factors contributed almost equally to this increase. The first is higher costs expected for a sizeable group of service recipients who came onto the waiver program in the spring (an expansion of the caseload for this program that was detailed in the November Forecast). The second factor is higher average costs for those on the program prior to the expansion. The latter appears to be the result of counties authorizing more costly service packages for the previous recipients during a period of time when caps on the cost of the service packages were artificially high. The Department of Human Services re-based those caps in December, but during the first five months of FY2002, spending for these recipients rose 4 percent on average.

Additionally, the Elderly Waiver, which provides community-based care for low-income senior citizens at risk of nursing home placement, is now forecast to be \$8.2 million higher, largely attributable to higher average costs.

Neither component of MA basic health care (MFIP & Other Families or Elderly & Disabled) has exhibited much change from the November levels.

Estimates of the General Assistance Medical Care are now 2 percent higher, an increase of \$8 million. This change is largely due to the sensitivity of GAMC to economic expectations, which are slightly more pessimistic than in November. Significantly higher estimates for the GAMC caseload are mitigated by lower average cost projections.

FY 2004-05 Health Care Estimates Increase \$43 Million

While the overall expectation for health care spending in the next biennium is virtually unchanged (0.8 percent increase), there are some significant changes within categories since the November Forecast. Increases in the current biennium for MA LTC Waivers continue into 2004-05, resulting in a \$63.8 million increase (5.2 percent).

MA Basic Care for the Elderly & Disabled is now forecast to be \$31.6 million higher than earlier projections, primarily driven by rising expectations for per person costs. This increase is almost entirely offset by a decrease in the estimate for MA Basic Care for MFIP & Other Families. Although MFIP caseloads are projected to be higher due to a more pessimistic economic outlook, lower spending projections for the Other Families

segment—due to reduced expectations for average cost and caseload growth—translate into overall reductions for this segment of the basic care forecast.

Health and Human Services

Health & Human Services Spending Declines Slightly for Current Biennium

Forecast spending for Health & Human Services is 0.5 percent lower than November estimates. The \$9.6 million decline is largely attributable to reductions in the Child Care Assistance forecast, with offsetting increases in the Minnesota Family Investment Program and General Assistance.

The forecast MFIP Child Care and Transition Year Child Care decreased by \$18.2 million (12 percent). While the forecast for the MFIP cash assistance caseload increased slightly, this was offset by lower estimates of MFIP and TY child care utilization based on recent data. The MFIP increase is the result of how MFIP and Child Care Assistance combine to form the biggest components of the state's maintenance-of-effort requirement under the federal TANF law (Temporary Assistance for Needy Families). The federal TANF fund still projects a balance of zero at the end of fiscal year 2003, as it did in November.

FY 2004-05 Health & Human Services Estimates Largely Unchanged

The forecast for Child Care Assistance is \$16.2 million lower than in the November forecast, primarily due to lower estimates of utilization for MFIP Child Care and Transition Year Child Care utilization. This decrease is offset by higher projected spending in MFIP (due to the MOE requirement), General Assistance, and Group Residential Housing. The net result is almost no change from earlier estimates.

The GA increase of \$3.5 million represents a 9 percent change from November. GA is sensitive to the economic environment, so the expectation for a “U-shaped” recovery in the February DRI-WEFA data contributes to the increases in 2004-05.

Federal TANF balances in 2004-05 are virtually unchanged from November. Assuming that federal funding continues at its current level, the 2005 TANF balance would be \$50.5 million.

Intergovernmental Aids

FY 2002-03 Aid Payments are Expected to be \$18 Million Higher

The intergovernmental aid forecast has increased by \$18 million. Sixteen million is due to an increase in the market value credit reimbursement. Eight million of this is net growth based on a growing number of homesteads qualifying, while \$8 million is related to a modified distribution between schools, cities and counties. Beginning with this forecast, iron ore production tax replacement aid is being included in the Intergovernmental Aids functional category. Previously this aid had been reported under

Education Finance. November forecast estimates have been restated to reflect this change. \$2 million of the forecast change is growth in iron ore production tax replacement aid.

FY 2004-05 Planning Estimates are \$17 Million Higher

For FY 2004-05, the intergovernmental aid forecast increased by a total of \$17 million. \$10 million is due to growth in market value credit reimbursement. \$8 million is due to a correction in how rental replacement aid is incorporate into ongoing Local Government Aid in FY 2005. The remainder is a small increase in property tax refunds and other miscellaneous changes.

All Other Spending

Remaining Spending Areas are \$8 Million Lower

The remaining categories of state spending total \$7.076 billion for the current biennium. Funding for these areas are set as fixed amounts by legislative appropriations. The net \$8 million decrease in remaining spending areas largely represents technical adjustments and corrections.

Within the net \$8 million decrease is a \$3.8 million increase shown for the Department of Military Affairs, an increase in open appropriation estimates associated with the costs incurred during the state employees strike in October.

Offsetting this increase are two reductions. The first is a \$7.6 million reduction in amounts shown for the Departments of Administration, Finance, and Employee Relations. The change corrects a double counting of appropriations carried forward from the previous fiscal year. This amount was originally budgeted as appropriations carried forward and reflected in end-of-session estimates as FY 2002 spending. When the books were closed for FY 2001, the actual amounts carried forward were added again.

The final item is a \$7.8 million increase to estimated cancellations. Most appropriations are available either to the end of the fiscal year or the end of the biennium and do not cancel until then. However, a separate appropriation for Digital TV had provisions for which the spending authority lapsed on January 15, 2002. This unusual mid-year cancellation has been added to the biennial estimate for total cancellations.

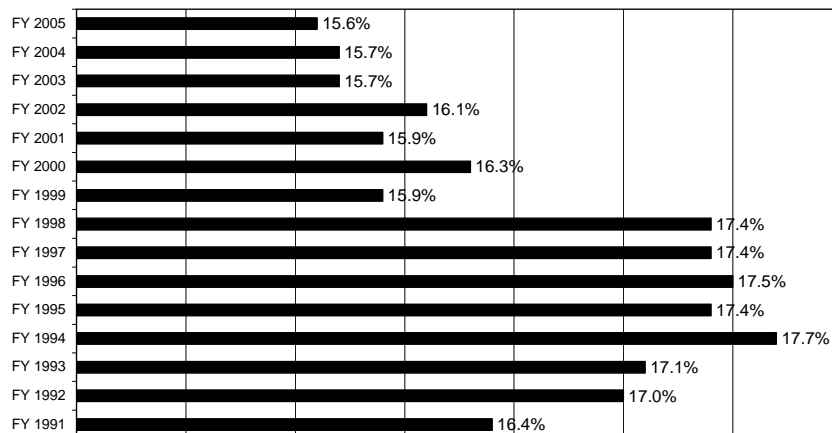
Price of Government

State and Local Government Revenues are Forecast Through 2005

The state general fund forecast represents only a portion of public sector revenues and spending in Minnesota. In broad terms, the “Price of Government” is a measure of the cost of all general government services statewide. It answers the question: ***How much do Minnesotans pay to state and local governments in total?*** It is comprehensive and includes nearly all revenues generated by state and local units of government as well as public school districts. All state taxes, property taxes, special assessments, fees and charges are included.

The aggregate annual receipts collected by each unit of government are considered to be a surrogate for the aggregate costs that Minnesota taxpayers pay for public services. The “Price of Government” measures that cost for each fiscal year relative to Minnesota Personal Income. The result is stated as a percentage of statewide personal income. For calendar year 2002, fiscal year 2003, it is estimated at 15.7 percent. In other words, for every dollar of Minnesota taxpayer personal income, 15.7 cents will be paid to state, county, township, and school districts for services during that year.

Minnesota Price of Government
State and Local Revenues as % of Personal Income



Since the price of government focuses on revenues collected by various levels of government, it is designed to be a performance measure for both taxpayers in general and policymakers during the budget formation process. Because the emphasis is on aggregate revenues, the measure serves as a financial index for the cost of public services in Minnesota.

The following table shows the revenues raised at each level of government, excluding federal grants or aids and excluding intergovernmental revenues such as state aid to school districts, cities and counties. The results are called “own source” revenues and represent the taxes, fees and charges at each level of government.

Own Source Revenues (\$ millions)				
	<u>FY 2002</u>	<u>Percent of Total</u>	<u>FY 2003</u>	<u>Percent of Total</u>
State Revenues				
Tax Revenues	\$ 13,218		\$ 14,103	
Non-Tax Revenues	<u>2,811</u>		<u>2,520</u>	
Total State Revenues	16,029	61%	16,623	63%
Local Non-School Revenues				
Tax Revenues	3,362		3,279	
Non-Tax Revenues	<u>4,508</u>		<u>4,689</u>	
Total Local Non-School Revenues	7,870	29%	7,968	30%
School District Revenues				
Tax Revenues	1,934		987	
Non-Tax Revenues	<u>662</u>		<u>675</u>	
Total School District Revenues	2,596	10%	1,662	7%
Total Own Source Revenues	26,495		26,254	
Minnesota Personal Income	\$164,621		\$167,149	
Governmental Revenue as Percent of Personal Income	16.1%		15.7%	

In FY 2003 – of all dollars Minnesotans will pay in taxes, fees and charges – the state will collect 63 percent. Counties, cities, and townships will collect about 30 percent, while school districts will collect about 7 percent. However, once intergovernmental aids are considered, the state will spend only 30 percent of the total while non-school local governments will spend 40 percent, and school districts 30 percent.

The Price of Government has changed only slightly from the November 2001 forecast. Both revenues and personal income have declined resulting in little overall change to the price of government percentages.

A table detailing price of government data is included in the appendix. It shows major taxes and other revenues sources for FY 1999 through FY 2005 broken down by level of government.

Selected Statutory Provisions

Minnesota Statutes 16A.152 Budget reserve and cash flow account.

Subdivision 1. Cash flow account established.

(a) A cash flow account is created in the general fund in the state treasury. The commissioner of finance shall restrict part or all of the balance before reserves in the general fund as may be necessary to fund the cash flow account as provided by law.

(b) The commissioner of finance shall transfer the amount necessary to bring the total amount of the cash flow account to \$350,000,000 on July 1, 1995. The amounts restricted shall remain in the account until drawn down and used to meet cash flow deficiencies resulting from uneven distribution of revenue collections and required expenditures during a fiscal year.

Subd. 1a. Budget reserve. A budget reserve account of \$653,000,000 is created in the general fund in the state treasury. The commissioner of finance shall transfer to the budget reserve account on July 1 of each odd-numbered year any amounts specifically appropriated by law to the budget reserve.

Subd. 2. Additional revenues; priority. If on the basis of a forecast of general fund revenues and expenditures, the commissioner of finance determines that there will be a positive unrestricted budgetary general fund balance at the close of the biennium, the commissioner of finance must allocate money to the budget reserve until the total amount in the account equals the amount set in this section.

The amounts necessary to meet the requirements of this section are appropriated from the general fund within two weeks after the forecast is released.

Subd. 3. Use. The use of the budget reserve should be governed by principles based on the full economic cycle rather than the budget cycle. The budget reserve may be used when a negative budgetary balance is projected and when objective measures, such as reduced growth in total wages, retail sales, or employment, reflect downturns in the state's economy.

Subd. 4. Reduction.

(a) If the commissioner determines that probable receipts for the general fund will be less than anticipated, and that the amount available for the remainder of the biennium will be less than needed, the commissioner shall, with the approval of the governor, and after consulting the legislative advisory commission, reduce the amount in the budget reserve account as needed to balance expenditures with revenue.

(b) An additional deficit shall, with the approval of the governor, and after consulting the legislative advisory commission, be made up by reducing unexpended allotments of any prior appropriation or transfer. Notwithstanding any other law to the contrary, the commissioner is empowered to defer or suspend prior statutorily created obligations which would prevent effecting such reductions.

(c) If the commissioner determines that probable receipts for any other fund, appropriation, or item will be less than anticipated, and that the amount available for the remainder of the term of the appropriation or for any allotment period will be less than needed, the commissioner shall notify the agency concerned and then reduce the amount allotted or to be allotted so as to prevent a deficit.

(d) In reducing allotments, the commissioner may consider other sources of revenue available to recipients of state appropriations and may apply allotment reductions based on all sources of revenue available.

(e) In like manner, the commissioner shall reduce allotments to an agency by the amount of any saving that can be made over previous spending plans through a reduction in prices or other cause.

Subd. 5. Restoration. The restoration of the budget reserve should be governed by principles based on the full economic cycle rather than the budget cycle. Restoration of the budget reserve should occur when objective measures, such as increased growth in total wages, retail sales, or employment, reflect upturns in the state's economy. The budget reserve should be restored before new or increased spending commitments are made.

Subd. 6. Notice to committees. The commissioner shall notify the committees on finance and taxes and tax laws of the senate and the committees on ways and means and taxes of the house of representatives of a reduction in an allotment under this section. The notice must be in writing and delivered within 15 days of the commissioner's act. The notice must specify:

- (1) the amount of the reduction in the allotment;
- (2) the agency and programs affected;
- (3) the amount of any payment withheld; and
- (4) any additional information the commissioner determines is appropriate.

Subd. 7. Delay; reduction. The commissioner may delay paying up to 15 percent of an appropriation to a special taxing district or a system of higher education in that entity's fiscal year for up to 60 days after the start of its next fiscal year. The delayed amount is subject to allotment reduction under subdivision 4.

HIST: 1973 c492 §23; 1978 c793 §47; 1981 c1 §2; 1 Sp1981 c5 §1; 2 Sp1981 c1 §3; 3 Sp1981 c1 art1 §1; 3 Sp1981 c2 art2 §3; 1983 c342 art18 §1-3; 1984 c502 art1 §1; 1984 c628 art2 §1; 1 Sp1985 c14 art18 §1,2,4; 1 Sp1986 c1 art5 §1-3; 1987 c268 art18 §1-3; 1988 c690 art2 §1; 1988 c719 art13 §1,2; 1989 c329 art1 §1; 1 Sp1989 c1 art15 §1,2; 1990 c604 art10 §4; 1991 c291 art21 §2; 1992 c511 art9 §1; 1993 c192 §58-63,111; 1993 c375 art17 §1,2; 1994 c632 art5 §1; 1994 c647 art1 §1; 1995 c264 art6 §1; 1 Sp1995 c3 art14 §1-3; 1996 c461 §1; 1996 c471 art10 §1; 1997 c231 art9 §1; 1998 c389 art9 §1; 1 Sp2001 c5 art20 §2,3; 1 Sp2001 c10 art2 §24

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Alternative Forecast Comparison

Real GDP (Annual Rates)

	<u>01 III</u>	<u>01V</u>	<u>02I</u>	<u>02II</u>	<u>02III</u>	<u>02IV</u>	<u>01A</u>	<u>02A</u>	<u>03A</u>
DRI Control (02-02)	-1.3	0.2	0.2	2.4	2.3	4.8	1.1	1.0	4.0
Blue Chip (02-02)	-1.3	0.2	1.6	2.9	3.6	3.7	1.1	1.5	3.5
Economy.Com (02-02)	-1.3	0.2	1.3	1.9	2.7	4.2	1.1	1.2	4.0
Merrill-Lynch (02-02)	-1.3	0.2	2.0	3.0	5.0	5.0	1.1	1.9	4.3
UBS Warburg/Paine Webber (02-02)	-1.3	0.2	1.0	3.0	3.2	4.0	1.1	1.3	3.5

Consumer Price Index (Annual Rates)

	<u>01 III</u>	<u>01V</u>	<u>02I</u>	<u>02II</u>	<u>02III</u>	<u>02IV</u>	<u>01A</u>	<u>02A</u>	<u>03A</u>
DRI Control (02-02)	0.7	-0.4	1.4	2.6	2.0	2.7	2.8	1.4	2.4
Blue Chip (02-02)	0.7	-0.4	1.4	2.0	2.1	2.3	2.8	1.5	2.4
Economy.Com (02-02)	0.7	-0.4	1.3	2.2	2.8	2.4	2.8	1.4	2.3
Merrill-Lynch (02-02)	0.7	-0.4	1.0	1.9	1.5	1.3	2.8	1.1	1.8
UBS Warburg/Paine Webber (02-02)	0.7	-0.4	N.A	N.A	N.A	N.A	1.9	2.0	2.5*

* 4Q/4Q

Forecast Comparisons

Real Economic Growth (Annual Percent Change in Real GDP)

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Feb 98 DRI Control	2.4	1.7 ⁽¹⁾				
Nov 98 DRI Control	2.3	2.1	1.7 ⁽²⁾	1.7 ⁽²⁾		
Feb 99 DRI Control	1.9	2.3	1.7 ⁽²⁾	1.7 ⁽²⁾		
Nov 99 DRI Control	3.4	3.5	2.0 ⁽³⁾	2.0 ⁽³⁾		
Feb 00 DRI Control	3.6	2.9	3.4	2.0 ⁽³⁾		
Nov 00 DRI Control	5.3	3.6	4.3	4.8	3.2 ⁽⁴⁾	3.2 ⁽⁴⁾
Feb 01 DRI Control	5.0	2.1	4.0	4.8	3.2 ⁽⁴⁾	3.2 ⁽⁴⁾
Nov 01 DRI Control	4.1	1.1	0.4	4.4	3.8	3.2 ⁽⁴⁾
Feb 02 DRI Control	4.1	1.1	1.0	4.0	3.9	3.2 ⁽⁴⁾

Inflation (Annual Percent Change in CPI-U)

Feb 98 DRI Control	2.9	2.8	2.8			
Nov 98 DRI Control	2.7	2.8	2.8	2.9		
Feb 99 DRI Control	2.3	2.3	2.4	2.5		
Nov 99 DRI Control	2.3	2.1	2.6	2.8		
Feb 00 DRI Control	2.4	2.2	2.5	2.6		
Nov 00 DRI Control	3.4	2.2	1.7	1.9	2.4 ⁽⁴⁾	2.7 ⁽⁴⁾
Feb 01 DRI Control	3.4	2.4	1.8	1.6	2.4 ⁽⁴⁾	2.7 ⁽⁴⁾
Nov 01 DRI Control	3.4	3.0	1.9	2.4	2.6	2.7
Feb 01 DRI Control	3.4	2.8	1.4	2.4	2.5	2.7

(1) Long-term trend from DRI Cyclelong, Summer 1997

(2) Long-term trend from DRI Cyclelong, Summer 1998

(3) Long-term trend from DRI Cyclelong, Summer 1999

(4) 10 year trend from DRI Early Recession (Pessim), November, 2000

Minnesota - U.S. Comparison Report

February 2002 Control (Annual Percent Changes)

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Wage and Salary Income							
United States	7.2	7.8	6.7	8.2	5.4	2.6	5.1
Minnesota	7.2	8.7	6.8	8.3	3.5	2.1	5.1
Implied Annual Wage							
United States	4.5	5.0	4.2	5.9	5.0	3.0	3.4
Minnesota	4.9	5.8	4.3	6.0	3.1	2.9	3.9
Non-Farm Employment							
United States	2.6	2.6	2.4	2.2	0.4	-0.4	1.6
Minnesota	2.2	2.7	2.3	2.2	0.3	-0.8	1.2
Personal Income							
United States	6.0	7.0	4.7	7.0	4.9	2.5	5.3
Minnesota	5.7	8.0	5.4	7.6	3.1	1.7	5.2

Comparison of Actual and Estimated Non-Restricted Revenues
Fiscal Year-To-Date Through January 2002
(\$ in Thousands)

	<u>Forecast Revenues</u>	<u>Actual Revenues</u>	<u>Variance Act-Fcst</u>
Individual Income Tax			
Withholding	2,873,700	2,832,920	-40,780
Declarations	628,500	562,367	-66,133
Miscellaneous	116,159	99,618	-16,540
Gross	3,618,359	3,494,906	-123,453
Refund	75,943	88,291	12,348
Net	3,542,416	3,406,615	-135,801
Corporate & Bank Excise			
Declarations	311,700	303,780	-7,920
Miscellaneous	61,900	68,953	7,053
Gross	373,600	372,733	-867
Refund	104,000	99,041	-4,959
Net	269,600	273,692	4,092
Sales Tax			
Gross	2,295,990	2,281,559	-14,431
Refunds	156,043	146,981	-9,062
Net	2,139,947	2,134,578	-5,369
1999 Sales Tax Rebates	0	0	0
2000 Sales Tax Rebates	-32	-32	0
2001 Sales Tax Rebates	9,887	7,247	-2,640
Motor Vehicle Sales	229,061	255,025	25,964
Other Revenues			
Inherit/Gift/Estate	34,471	41,992	7,521
Liquor/Wine/Beer	32,615	33,045	430
Cigarette/Tobacco/Cont Sub	93,004	97,725	4,721
Deed and Mortgage	117,851	131,846	13,995
Insurance Gross Earnings	56,817	58,161	1,345
Lawful Gambling	29,663	29,703	40
Health Care Surcharge	71,484	72,315	831
Other Taxes	758	651	-107
DHS RTC Collections	30,571	43,097	12,526
Income Tax Reciprocity	47,900	47,899	-1
Investment Income	55,338	53,996	-1,342
Tobacco Settlement	151,545	147,734	-3,811
Departmental Earnings	116,424	121,775	5,351
Lottery Revenues	18,989	19,204	215
Revenues yet to be allocated	2,749	9,596	6,847
Residual revenues	46,593	41,391	-5,203
Other Subtotal	916,625	957,345	40,719
Other Refunds	9,741	8,515	-1,225
Other Net	906,885	948,829	41,945
Total Gross	7,433,635	7,361,567	-72,067
Total Refunds	345,727	342,828	-2,899
Total Net	7,087,908	7,018,740	-69,169

Factors Affecting the Individual Income Tax

(\$ in billions)

	Calendar Year					
	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Minnesota Non-Farm Tax Base						
February 1998 Control	113.040	116.960				
November 1998 Control	113.850	118.500	123.620	128.830		
February 1999 Control	114.640	120.320	125.150	130.330		
November 1999 Control	112.920	119.790	126.630	133.200		
February 2000 Control	112.920	120.416	127.870	134.090		
November 2000 Control	120.590	128.770	138.670	146.530	155.040	165.080
February 2001 Control	120.590	128.770	139.420	145.300	152.840	162.610
November 2001 Control	121.500	128.930	139.610	144.440	146.880	155.990
February 2002 Control	121.500	128.930	139.610	143.910	145.890	153.470
Minnesota Wage and Salary Income						
February 1998 Control	81.433	84.502				
November 1998 Control	82.538	86.724	91.370	95.761		
February 1999 Control	83.279	87.884	91.969	96.329		
November 1999 Control	83.980	89.550	95.060	100.590		
February 2000 Control	83.980	90.080	95.600	100.500		
November 2000 Control	83.750	89.680	96.555	102.910	109.420	116.870
February 2001 Control	83.750	89.680	97.350	102.290	108.100	115.190
November 2001 Control	83.400	89.070	96.490	100.340	102.920	109.210
February 2002 Control	83.400	89.070	96.490	99.840	101.910	107.140
Minnesota Property Income						
February 1998 Control	23.112	23.606				
November 1998 Control	23.117	23.348	23.438	23.891		
February 1999 Control	23.129	23.787	24.317	24.821		
November 1999 Control	20.913	21.464	22.523	23.243		
February 2000 Control	20.813	21.509	22.984	23.956		
November 2000 Control	28.761	30.377	32.711	33.690	35.015	36.754
February 2001 Control	28.761	30.377	32.670	33.216	34.163	36.102
November 2001 Control	29.635	30.777	33.339	33.868	33.184	35.201
February 2002 Control	29.635	30.777	33.339	33.851	33.466	35.074
Minnesota Proprietors' Income						
February 1998 Control	8.500	8.855				
November 1998 Control	8.193	8.429	8.808	9.182		
February 1999 Control	8.230	8.651	8.867	9.181		
November 1999 Control	8.134	8.774	9.045	9.365		
February 2000 Control	8.134	8.820	9.288	9.636		
November 2000 Control	8.079	8.710	9.405	9.938	10.607	11.455
February 2001 Control	8.079	8.710	9.407	9.800	10.570	11.323
November 2001 Control	8.464	9.079	9.778	10.232	10.779	11.586
February 2002 Control	8.464	9.079	9.778	10.216	10.515	11.256

**Factors Affecting Sales Tax, Corporate Income Tax,
and Sales Tax on Motor Vehicles**
(\$ in billions)

	Fiscal Year					
	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
SALES TAX						
Minnesota's Proxy Share of U.S. Consumer Durable Spending (Excluding Autos)						
February 1998 Control	8.802	9.226				
November 1998 Control	9.182	9.750	10.207	10.662		
February 1999 Control	9.187	9.854	10.456	10.828		
November 1999 Control	8.962	9.729	10.442	11.041		
February 2000 Control*	8.307	8.968	9.648	10.100		
November 2000 Control	8.196	8.895	9.875	10.512	11.124	11.978
February 2001 Control**	8.560	9.253	10.307	10.783	11.180	12.043
November 2001 Control*	8.606	9.247	10.193	10.725	10.477	10.784
February 2002 Control	8.606	9.247	10.193	10.723	10.740	10.843
Minnesota's Proxy Share of U.S. Capital Equipment Spending						
November 1997 Control	9.461	10.148				
February 1998 Control	9.344	10.038				
November 1998 Control	9.475	10.338	10.743	11.224		
February 1999 Control	9.485	10.417	11.103	11.461		
November 1999 Control	9.452	10.384	11.519	12.189		
February 2000 Control*	9.541	10.288	11.362	12.161		
November 2000 Control	9.448	10.059	11.243	12.887	13.717	14.577
February 2001 Control	9.448	10.059	11.267	12.272	12.850	13.868
November 2001 Control*	9.411	9.902	10.913	11.475	9.671	9.812
February 2002 Control	9.411	9.902	10.913	11.474	9.683	9.850
Minnesota's Proxy Share of U.S. Construction Spending						
February 1998 Control	5.810	6.066				
November 1998 Control	5.983	6.259	6.620	6.927		
February 1999 Control	5.983	6.593	6.872	7.081		
November 1999 Control	6.018	6.727	7.278	7.671		
February 2000 Control*	6.126	6.863	7.404	7.540		
November 2000 Control	6.213	6.904	7.595	7.677	7.985	8.507
February 2001 Control	6.213	6.904	7.595	7.818	7.955	8.386
November 2001 Control*	6.185	6.890	7.545	8.152	8.438	8.545
February 2002 Control	6.185	6.890	7.545	8.152	8.345	8.420

* Reflects data revision.

** Reflects change in data definition

Factors Affecting Sales, Corporate Income And Sales Tax on Motor Vehicles

(\$ in billions)

	Fiscal Year					
	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
SALES TAX (Cont.)						
Minnesota's Non-Farm Personal Income						
February 1998 Control	128.73	133.98				
November 1998 Control	129.20	135.40	141.19	147.71		
February 1999 Control	129.58	136.44	142.42	148.03		
November 1999 Control*	126.46	133.73	141.35	147.91		
February 2000 Control	126.46	133.76	142.37	149.75		
November 2000 Control	133.41	142.02	152.34	161.70	170.86	181.54
February 2001 Control	133.41	142.03	152.78	161.59	169.03	179.41
November 2001 Control	133.39	141.65	151.24	161.58	163.61	174.93
February 2002 Control	138.11	145.84	157.17	162.38	165.28	173.63

SALES TAX ON MOTOR VEHICLES

Minnesota's Proxy Share of U.S. Consumption of Motor Vehicle and Parts

February 1998 Control	5.293	5.392				
November 1998 Control	5.550	5.575	5.718	5.900		
February 1999 Control	5.576	5.955	5.803	6.039		
November 1999 Control*	5.519	6.066	6.425	6.519		
February 2000 Control	5.519	6.068	6.574	6.517		
November 2000 Control	5.513	6.099	6.646	6.671	6.764	7.452
February 2001 Control	5.513	6.099	6.630	6.444	6.566	7.080
November 2001 Control	5.491	6.136	6.780	7.097	7.007	7.484
February 2002 Control	5.594	6.216	6.894	7.163	7.403	7.506

CORPORATE FRANCHISE TAX

Calendar Year

U.S. Corporate Profits

February 1998 Control	756.3	754.3				
November 1998 Control	711.8	678.9	697.4	710.9	697.4	710.9
February 1999 Control	725.6	732.1	678.9	688.4	678.9	688.4
November 1999 Control*	781.9	853.9	883.8	894.2	883.8	894.2
February 2000 Control	781.9	855.3	849.7	823.4	849.7	823.4
November 2000 Control	758.2	823.0	940.7	910.0	993.5	1,089.0
February 2001 Control	758.2	823.0	929.5	892.2	1,006.3	1,066.2
November 2001 Control	721.1	776.3	845.4	663.6***	685.7	761.2
February 2002 Control	721.1	776.3	845.4	631.9	722.1	786.0

* Data Revision.

** Change in Definition

*** Finance Dept Estimate

FEBRUARY 2002 GENERAL FUND FORECAST

Current Biennium

(\$ in thousands)

	FY 2002	FY 2003	Biennial Total
<u>Actual & Estimated Resources</u>			
Balance Forward From Prior Year	1,574,200	561,460	1,574,200
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	5,736,500	6,051,000	11,787,500
Sales Tax	3,720,209	3,865,588	7,585,797
Corporate Income Tax	530,700	625,300	1,156,000
Motor Vehicle Sales Tax	418,228	274,401	692,629
Statewide Property Tax	296,000	594,851	890,851
Tobacco Settlements	149,614	151,592	301,206
Other Non-Dedicated Revenue	1,365,086	1,326,898	2,691,984
Subtotal Net Non-Dedicated Revenue	12,216,337	12,889,630	25,105,967
Dedicated Revenue	48,385	44,576	92,961
Transfers In	41,112	30,761	71,873
Prior Year Adjustments	(127,257)	10,100	(117,157)
Subtotal Current Resources	12,178,577	12,975,067	25,153,644
Total Resources Available	13,752,777	13,536,527	26,727,844
<u>Actual & Estimated Spending by Function</u>			
Education Finance	4,951,169	6,168,233	11,119,402
Higher Education	1,388,727	1,464,114	2,852,841
Intergovernmental Aids	1,371,628	1,493,723	2,865,351
Health Care	2,213,805	2,498,206	4,712,011
Health & Human Services	1,011,954	1,058,517	2,070,471
Environmental Resources	267,772	271,954	539,726
Economic & Workforce Development	204,568	193,078	397,646
Public Safety & Corrections	485,755	482,831	968,586
Transportation	350,707	86,634	437,341
General Government	605,072	581,783	1,186,855
Debt Service	285,575	322,385	607,960
Transportation Projects/Tabs	19,000	0	19,000
Estimated Cancellations	(12,800)	(15,000)	(27,800)
Subtotal - Major Spending Categories	13,142,932	14,606,458	27,749,390
Dedicated Expenditures	48,385	44,576	92,961
Total Expenditures & Transfers	13,191,317	14,651,034	27,842,351
Balance Before Reserves	561,460	(1,114,507)	(1,114,507)
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	653,000	653,000	653,000
Tax Relief Account	158,148	158,148	158,148
Dedicated Reserves	0	14,000	14,000
Budgetary Balance	(599,688)	(2,289,655)	(2,289,655)

COMPARISON: FY 2002-03 GENERAL FUND FORECAST
February 2002 vs November 2001
(\$ in thousands)

	11-01 Fcst FY 2002-03	02-02 Fcst FY 2002-03	\$ Difference	% Change
<u>Actual & Estimated Resources</u>				
Balance Forward From Prior Year	1,574,200	1,574,200	0	0.0%
Current Resources:				
Net Non-Dedicated Revenue				
Individual Income Tax	12,190,900	11,787,500	(403,400)	-3.3%
Sales Tax	7,491,784	7,585,797	94,013	1.3%
Corporate Income Tax	1,201,900	1,156,000	(45,900)	-3.8%
Motor Vehicle Sales Tax	665,627	692,629	27,002	4.1%
Statewide Property Tax	893,443	890,851	(2,592)	-0.3%
Tobacco Settlements	304,988	301,206	(3,782)	-1.2%
Other Non-Dedicated Revenue	2,663,909	2,691,984	28,075	1.1%
Subtotal Net Non-Dedicated Revenue	25,412,551	25,105,967	(306,584)	-1.2%
Dedicated Revenue	92,356	92,961	605	0.7%
Transfers In	66,521	71,873	5,352	8.0%
Prior Year Adjustments	(117,157)	(117,157)	0	0.0%
Subtotal Current Resources	25,454,271	25,153,644	(300,627)	-1.2%
Total Resources Available	27,028,471	26,727,844	(300,627)	-1.1%
<u>Actual & Estimated Spending by Function</u>				
Education Finance	11,147,227	11,119,402	(28,016)	-0.2%
Higher Education	2,852,941	2,852,841	(100)	0.0%
Intergovernmental Aids	2,847,189	2,865,351	18,162	0.6%
Health Care	4,647,523	4,712,011	64,488	1.4%
Health & Human Services	2,080,093	2,070,471	(9,622)	-0.5%
Environmental Resources	539,890	539,726	(164)	0.0%
Economic & Workforce Development	397,879	397,646	(233)	-0.1%
Public Safety & Corrections	964,888	968,586	3,889	0.4%
Transportation	437,341	437,341	0	0.0%
General Government	1,192,281	1,186,855	(5,426)	-0.5%
Debt Service	607,893	607,960	67	0.0%
Transportation Projects/Tabs	19,000	19,000	0	0.0%
Estimated Cancellations	(20,000)	(27,800)	(7,800)	39.0%
Subtotal - Major Spending Categories	27,714,145	27,749,390	35,245	0.1%
Dedicated Expenditures	92,356	92,961	605	0.7%
Total Expenditures & Transfers	27,806,501	27,842,351	35,850	0.1%
Balance Before Reserves	(778,030)	(1,114,507)	(336,477)	
Cash Flow Account	350,000	350,000	0	
Budget Reserve	653,000	653,000	0	
Tax Relief Account	158,148	158,148	0	
Dedicated Reserves	14,000	14,000	0	
Budgetary Balance	(1,953,178)	(2,289,655)	(336,477)	

FY 2004-05 GENERAL FUND PLANNING ESTIMATES

FY 2004, FY 2005, Biennial Total

(\$ in thousands)

	FY 2004	FY 2005	Biennial Total
<u>Actual & Estimated Resources</u>			
Balance Forward From Prior Year	(1,114,507)	(2,787,299)	(1,114,507)
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	6,542,600	6,953,000	13,495,600
Sales Tax	3,997,200	4,346,800	8,344,000
Corporate Income Tax	690,300	703,500	1,393,800
Motor Vehicle Sales Tax	284,218	285,767	569,985
Statewide Property Tax	604,960	621,030	1,225,990
Tobacco Settlements	188,723	190,822	379,545
Other Non-Dedicated Revenue	1,365,026	1,404,047	2,769,073
Subtotal Net Non-Dedicated Revenue	13,673,027	14,504,966	28,177,993
Dedicated Revenue	57,401	57,589	114,990
Transfers In	31,088	31,118	62,206
Prior Year Adjustments	10,100	10,100	20,200
Subtotal Current Resources	13,771,616	14,603,773	28,375,389
Total Resources Available	12,657,109	11,816,474	27,260,882
<u>Actual & Estimated Spending by Function</u>			
Education Finance	6,338,803	6,374,023	12,712,826
Higher Education	1,477,496	1,477,496	2,954,992
Intergovernmental Aids	1,531,258	1,566,932	3,098,190
Health Care	2,628,523	2,809,474	5,437,997
Health & Human Services	1,082,381	1,095,298	2,177,679
Environmental Resources	271,049	269,130	540,179
Economic & Workforce Development	181,411	181,281	362,692
Public Safety & Corrections	492,320	507,720	1,000,040
Transportation	84,134	84,134	168,268
General Government	621,557	639,033	1,260,590
Debt Service	310,352	327,696	638,048
Transportation Projects/Tabs	5,000	10,000	15,000
Estimated Cancellations	(5,000)	(15,000)	(20,000)
Estimated Inflation	367,723	759,604	1,127,327
Subtotal - Major Spending Categories	15,387,007	16,086,821	31,473,828
Dedicated Expenditures	57,401	57,589	114,990
Total Expenditures & Transfers	15,444,408	16,144,410	31,588,818
Balance Before Reserves	(2,787,299)	(4,327,936)	(4,327,936)
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	684,000	684,000	684,000
Tax Relief Account	158,148	158,148	158,148
Dedicated Reserves	38,459	79,347	79,347
Budgetary Balance	(4,017,906)	(5,599,431)	(5,599,431)

COMPARISON: FY 2004-05 GENERAL FUND PLANNING ESTIMATES
February 2002 vs November 2001

(\$ in thousands)

	11-01 Plng Est FY 2004-05	02-02 Plng Est FY 2004-05	\$ Difference	% Change
<u>Actual & Estimated Resources</u>				
Balance Forward From Prior Year	(778,030)	(1,114,507)	(336,477)	43.2%
Current Resources:				
Net Non-Dedicated Revenue				
Individual Income Tax	13,909,600	13,495,600	(414,000)	-3.0%
Sales Tax	8,551,022	8,344,000	(207,022)	-2.4%
Corporate Income Tax	1,446,700	1,393,800	(52,900)	-3.7%
Motor Vehicle Sales Tax	561,001	569,985	8,984	1.6%
Statewide Property Tax	1,236,098	1,225,990	(10,108)	-0.8%
Tobacco Settlements	384,176	379,545	(4,631)	-1.2%
Other Non-Dedicated Revenue	2,757,853	2,769,073	11,220	0.4%
Subtotal Net Non-Dedicated Revenue	28,846,450	28,177,993	(668,457)	-2.3%
Dedicated Revenue	113,801	114,990	1,189	1.0%
Transfers In	66,240	62,206	(4,034)	-6.1%
Prior Year Adjustments	20,200	20,200	0	0.0%
Subtotal Current Resources	29,046,691	28,375,389	(671,302)	-2.3%
Total Resources Available	28,268,661	27,260,882	(1,007,779)	-3.6%
<u>Actual & Estimated Spending by Function</u>				
Education Finance	12,765,435	12,712,826	(52,609)	-0.4%
Higher Education	2,955,092	2,954,992	(100)	0.0%
Intergovernmental Aids	3,081,451	3,098,190	16,739	0.5%
Health Care	5,395,449	5,437,997	42,548	0.8%
Health & Human Services	2,177,716	2,177,679	(37)	0.0%
Environmental Resources	540,419	540,179	(240)	0.0%
Economic & Workforce Development	362,694	362,692	(2)	0.0%
Public Safety & Corrections	1,000,145	1,000,040	(105)	0.0%
Transportation	168,268	168,268	0	0.0%
General Government	1,261,021	1,260,590	(431)	0.0%
Debt Service	637,845	638,048	203	0.0%
Transportation Projects/Tabs	15,000	15,000	0	N/A
Estimated Cancellations	(20,000)	(20,000)	0	0.0%
Estimated Inflation	1,127,169	1,127,327	158	n/a
Subtotal - Major Spending Categories	31,467,704	31,473,828	6,124	0.0%
Dedicated Expenditures	113,801	114,990	1,189	1.0%
Total Expenditures & Transfers	31,581,505	31,588,818	7,313	0.0%
Balance Before Reserves	(3,312,844)	(4,327,936)	(1,015,092)	
Cash Flow Account	350,000	350,000	0	
Budget Reserve	684,000	684,000	0	
Tax Relief Account	158,148	158,148	0	
Dedicated Reserves	84,271	79,347	(4,924)	
Budgetary Balance	(4,589,263)	(5,599,431)	(1,010,168)	

CUMULATIVE FORECAST CHANGE
End of 2001 Legislative Session vs February 2002 Forecast
(\$ in thousands)

	End of Session	February Forecast	\$ Difference	% Change
<u>Actual & Estimated Resources</u>				
Balance Forward From Prior Year	1,109,357	1,574,200	464,843	41.9%
Current Resources:				
Net Non-Dedicated Revenue				
Individual Income Tax	13,064,138	11,787,500	(1,276,638)	-9.8%
Sales Tax	8,320,621	7,585,797	(734,824)	-8.8%
Corporate Income Tax	1,671,880	1,156,000	(515,880)	-30.9%
Motor Vehicle Sales Tax	624,247	692,629	68,382	11.0%
Statewide Property Tax	888,000	890,851	2,851	0.3%
Tobacco Settlements	313,708	301,206	(12,502)	-4.0%
Other Non-Dedicated Revenue	2,631,183	2,691,984	60,801	2.3%
Subtotal Net Non-Dedicated Revenue	27,513,777	25,105,967	(2,407,810)	-8.8%
Dedicated Revenue	86,922	92,961	6,039	6.9%
Transfers In	66,028	71,873	5,845	8.9%
Prior Year Adjustments	(117,157)	(117,157)	0	0.0%
Subtotal Current Resources	27,549,570	25,153,644	(2,395,926)	-8.7%
Total Resources Available	28,658,927	26,727,844	(1,931,083)	-6.7%
<u>Actual & Estimated Spending by Function</u>				
Education Finance	11,064,907	11,119,402	54,495	0.5%
Higher Education	2,844,253	2,852,841	8,588	0.3%
Intergovernmental Aids	2,849,583	2,865,351	15,768	0.6%
Health Care	4,653,626	4,712,011	58,385	1.3%
Health & Human Services	2,036,976	2,070,471	33,495	1.6%
Environmental Resources	539,437	539,726	289	0.1%
Economic & Workforce Development	394,914	397,646	2,732	0.7%
Public Safety & Corrections	956,983	968,586	11,603	1.2%
Transportation	177,612	437,341	259,729	146.2%
General Government	1,172,956	1,186,855	13,899	1.2%
Debt Service	629,739	607,960	(21,779)	-3.5%
Transportation Projects/Tabs	19,000	19,000	0	0.0%
Estimated Cancellations	(20,000)	(27,800)	(7,800)	39.0%
Subtotal - Major Spending Categories	27,319,986	27,749,390	429,404	1.6%
Dedicated Expenditures	86,922	92,961	6,039	6.9%
Total Expenditures & Transfers	27,406,908	27,842,351	435,443	1.6%
Balance Before Reserves	1,252,019	(1,114,507)	(2,366,526)	
Cash Flow Account	350,000	350,000	0	
Budget Reserve	653,000	653,000	0	
Tax Relief Account	0	158,148	158,148	
Dedicated Reserves	14,000	14,000	0	
Budgetary Balance	235,019	(2,289,655)	(2,524,674)	

**February 2002 Forecast
Price of Government
State & Local Revenues, C.Y. 1998-2004
as a Percent of Personal Income
(\$ in Thousands)**

	C.Y. 1998 F.Y. 1999	C.Y. 1999 F.Y. 2000	C.Y. 2000 F.Y. 2001	C.Y. 2001 F.Y. 2002	C.Y. 2002 F.Y. 2003	C.Y. 2003 F.Y. 2004	C.Y. 2004 F.Y. 2005
State Revenues							
<i>Tax Revenues:</i>							
Individual Income Tax	5,320,918	5,556,366	5,915,494	5,736,500	6,051,000	6,542,600	6,953,000
General Sales Tax	2,140,351	3,120,309	3,037,362	3,741,415	3,886,794	4,018,772	4,368,372
Corporate Income Tax	777,491	800,129	728,970	530,700	625,300	690,300	703,500
Gasoline & Special Fuels Taxes	583,264	612,894	612,070	631,950	646,534	661,625	677,058
Motor Vehicle License Tax	556,282	606,844	454,554	480,311	496,237	512,092	528,490
Motor Vehicle Sales Tax	487,041	540,961	546,157	604,900	593,300	642,300	645,800
Statewide Property Tax	0	0	0	296,000	594,851	604,960	621,030
Health Care Taxes	137,529	151,034	167,315	181,104	197,867	259,184	361,150
All Other Taxes	936,798	972,300	944,430	1,014,775	1,011,618	1,039,513	1,069,201
Subtotal - State Taxes	10,939,674	12,360,837	12,406,352	13,217,655	14,103,501	14,971,346	15,927,601
<i>Non-Tax Revenues:</i>							
Fees & Charges	471,427	524,857	526,035	628,749	636,713	662,909	680,716
Investment Earnings	315,222	278,512	342,347	287,466	239,150	248,752	243,572
Post-Secondary Tuition	479,621	509,774	550,302	618,488	624,871	624,871	624,871
Tobacco Settlements	0	104,926	130,254	149,614	151,592	188,723	190,822
All Other Resources	694,878	627,661	1,261,441	1,126,748	867,555	751,420	712,660
Subtotal - State Non-Tax Revenues	1,961,148	2,045,730	2,810,379	2,811,065	2,519,881	2,476,675	2,452,641
Subtotal - State Own Source Revenues	12,900,822	14,406,567	15,216,731	16,028,720	16,623,382	17,448,021	18,380,242
Federal Grants	3,805,703	4,144,935	4,713,058	4,841,746	5,112,324	4,967,715	4,951,710
TOTAL STATE REVENUES	16,706,525	18,551,502	19,929,789	20,870,466	21,735,706	22,415,736	23,331,952
Local Non-School Revenues							
<i>Tax Revenues:</i>							
Property Tax	2,670,768	2,778,424	2,906,889	3,128,192	3,038,678	3,194,647	3,365,636
Sales Tax	94,470	101,768	103,244	101,442	100,777	106,521	118,003
Other Taxes	125,676	128,689	132,640	132,614	139,272	139,934	140,805
Subtotal - Local Taxes	2,890,914	3,008,881	3,142,773	3,362,248	3,278,727	3,441,102	3,624,444
<i>Non-Tax Revenues:</i>							
Special Assessments	270,853	289,459	309,386	330,728	344,850	358,712	373,172
Licenses and Permits	122,067	136,880	153,527	172,239	179,582	186,791	194,309
Charges for Services	640,733	702,605	770,525	845,089	878,214	910,455	943,987
Investment Earnings	355,497	370,717	386,646	403,322	416,693	430,045	443,848
Selected Enterprise Revenues	2,049,239	2,129,133	2,213,610	2,302,937	2,397,850	2,490,713	2,587,454
Miscellaneous Revenues	398,050	415,601	434,256	454,088	472,502	490,488	509,216
Subtotal - Local Non-Tax Revenues	3,836,439	4,044,395	4,267,950	4,508,403	4,689,691	4,867,204	5,051,986
Subtotal - Local Own Source Revenues	6,727,353	7,053,276	7,410,723	7,870,651	7,968,418	8,308,306	8,676,430
<i>Intergovernmental Revenue:</i>							
State Aid	2,157,447	2,258,959	2,343,194	2,238,280	2,553,007	2,602,427	2,662,385
Local Aid	82,756	94,055	94,055	94,055	94,055	94,055	94,055
Federal Aid	486,020	506,643	491,500	491,500	491,500	491,500	491,500
Subtotal - Intergovernmental Revenue	2,726,223	2,859,657	2,928,749	2,823,835	3,138,562	3,187,982	3,247,940
TOTAL LOCAL NON-SCHOOL REVENUES	9,453,576	9,912,933	10,339,472	10,694,486	11,106,980	11,496,288	11,924,370

**February 2002 Forecast
Price of Government
State & Local Revenues, C.Y. 1998-2004
as a Percent of Personal Income
(\$ in Thousands)**

	C.Y. 1998 F.Y. 1999	C.Y. 1999 F.Y. 2000	C.Y. 2000 F.Y. 2001	C.Y. 2001 F.Y. 2002	C.Y. 2002 F.Y. 2003	C.Y. 2003 F.Y. 2004	C.Y. 2004 F.Y. 2005
<u>School District Revenues</u>							
<i>Tax Revenues:</i>							
Property Tax	1,973,608	1,838,874	1,793,013	1,922,340	986,808	1,178,229	1,330,843
Taconite Production Tax	23,274	12,110	11,553	11,393	0	0	0
Subtotal - School District Tax Revenues	1,996,882	1,850,984	1,804,566	1,933,733	986,808	1,178,229	1,330,843
<i>Non-Tax Revenues:</i>							
Sales & Fee Revenue	165,450	180,258	187,693	191,447	195,276	199,181	203,165
Other Miscellaneous Revenue	403,241	414,646	461,506	470,736	480,151	489,754	499,549
Subtotal - School District Non Tax Revenues	568,691	594,904	649,199	662,183	675,427	688,935	702,714
Subtotal - School Dist Own Source Revenues	2,565,573	2,445,888	2,453,765	2,595,916	1,662,235	1,867,164	2,033,557
<i>Intergovernmental Revenue:</i>							
State Aid	3,564,226	3,955,138	4,268,222	4,359,324	6,123,165	6,169,296	6,204,323
State Paid Tax Credits	77,649	48,189	39,129	27,950	6,485	5,587	5,409
Education Homestead Credit	160,271	304,629	395,013	404,102	876	221	0
Education Agricultural Credit	0	0	45,979	55,116	0	0	0
Market Value Homestead Credit	0	0	0	0	67,259	69,042	70,767
Homestead Agric Land MV Credit	0	0	0	0	3,674	3,766	3,860
Local Aid	30,023	27,426	27,701	28,860	29,096	29,684	29,977
Federal Aid	317,583	341,744	370,319	396,241	423,978	453,657	485,413
Subtotal - Intergovernmental Revenue	4,149,752	4,677,126	5,146,363	5,271,593	6,654,533	6,731,253	6,799,749
TOTAL SCHOOL DISTRICT REVENUES	6,715,325	7,123,014	7,600,128	7,867,509	8,316,768	8,598,417	8,833,306
<u>Total State, Local & School District Revenues</u>							
Tax Revenues	15,827,470	17,220,702	17,353,691	18,513,636	18,369,036	19,590,677	20,882,888
Non-Tax Revenues	6,366,278	6,685,029	7,727,528	7,981,651	7,884,999	8,032,814	8,207,341
Intergovernmental Revenue	10,681,678	11,681,718	12,788,170	12,937,174	14,905,419	14,886,950	14,999,399
TOTAL ALL REVENUES	32,875,426	35,587,449	37,869,389	39,432,461	41,159,454	42,510,441	44,089,628
Less: Intergovernmental Revenues	(10,670,687)	(11,681,718)	(12,788,170)	(12,937,174)	(14,905,419)	(14,886,950)	(14,999,399)
Total Own Source Revenues	22,193,748	23,905,731	25,081,219	26,495,287	26,254,035	27,623,491	29,090,229
Minnesota Personal Income	139,970,000	146,685,000	157,931,750	164,621,250	167,148,750	175,820,500	186,492,500
Revenue as Percent of Personal Income	15.9%	16.3%	15.9%	16.1%	15.7%	15.7%	15.6%